No. 936

IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1946.

ST. LOUIS SOUTHWESTERN RAILWAY COMPANY,
a Corporation, Debtor,
Petitioner,

vs.

BERRYMAN HENWOOD, as Trustee of ST. LOUIS SOUTHWESTERN RAILWAY COMPANY LINES, et al.,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

and

BRIEF IN SUPPORT THEREOF.

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To the United States Circuit Court of Appeals for the Eighth Circuit.

To the Honorable the Chief Justice of the United States, and to the Associate Justices of the Supreme Court of the United States:

Your Petitioner, St. Louis Southwestern Railway Company, a Corporation, Debtor, the appellant in the above captioned case in the United States Circuit Court of Appeals for the Eighth Circuit, numbered 12882 therein, prays that a writ of certiorari issue to review the opinion and judgment of that court. Said judgment (R. 5559-5683) affirmed, substantially, the order of the United States District Court for the Eastern District of Missouri (R. 5183-5213) approving the plan of reorganization for Debtor certified by the Interstate Commerce Commission under Section 77 of the Bankruptcy Act (11 U. S. C. Sec. 205) (R. 3495-3733, 3736-3820).

SUMMARY STATEMENT OF THE MATTER INVOLVED.

The St. Louis Southwestern Railway Company, a Missouri Corporation, Debtor, on December 12, 1935, filed in the District Court of the United States for the Eastern Division of the Eastern Judicial District of Missouri, a voluntary petition for reorganization under Section 77 of the Bankruptcy Act (11 U. S. C. Sec. 205) (R. 24). On the same day a copy of the petition was filed with the Interstate Commerce Commission (R. 26). The District Court entered an order approving the Debtor's petition on December 12, 1935 (R. 27, 256).

The Debtor filed its proposed plan of reorganization with the Interstate Commerce Commission on December 7, 1936, and other plans were subsequently submitted (R. 258). Hearings on the proposed plans were held before the Commission during March and April of 1937 (R. 96 et seq.). Additional hearings were held before the Commission from May 5, 1939 to May 27, 1939, and from September 18, 1939 to September 30, 1939 (R. 529-3049).

On June 30, 1941, the Commission submitted its Report and Order approving a plan of reorganization for the Debtor (R. 3495-3733). Various petitions for modification of the plan were filed with the Commission (R. 3736-3737). Under date of March 9, 1942, a supplemental Report and Order were issued by the Commission disposing of the petitions theretofore filed and modifying in some minor respects its original report of June 30, 1941. As thus modified, the Commission again approved the plan of reorganization for the Debtor which had been approved by the report of June 30, 1941 (R. 3736-3820).

The existing capitalization of the Road was found to be the sum of $105,944,706, including loans and bills pay-

able as of January 1, 1942 (R. 3785). The Commission approved a capitalization of $75,000,000, of which 50 per cent is funded debt, 25 per cent preferred stock, and 25 per cent common stock (R. 3692, 3774). In reaching this result, the Commission adhered to its original conclusion which was stated by it as follows (R. 3700):

> "Thus, debt claims totaling $8,304,118 can receive no recognition within the limits of capitalization approved. From a consideration of the entire record, including the elements of value referred to, the earnings and prospective earnings, and especially the impairment in earning power of the properties, we conclude and find that this result cannot be avoided. Consistently therewith, we further find that the equities of the holders of the stock of the debtor have no value."

In due time various parties in interest filed objections to the report, and to the plan as approved by the Commission under date of March 9, 1942, effective January 1, 1942 (R. 3828, 3835, 3840, 3849, 3854, 4011).

A hearing was had before Judge Davis between the dates of October 26, 1942 and November 5, 1942 upon Debtor's objections and the exceptions of the other parties to the Report and Order of the Interstate Commerce Commission and its supplemental report. Evidence was taken at considerable length (R. 4051-5136) and a date set for arguments. Prior to the arguments and before the briefs of the various objectors had been filed, Judge Davis died. Thereafter Judge Moore made an order directing a reargument on May 31, 1943, and taking the cause as submitted on the record made before the late Judge Davis (R. 5137-5183).

On February 8, 1944, the District Court made and entered an order approving the plan of reorganization certified to it by the Commission (R. 5183-5213).

Appeals were taken to the United States Circuit Court of Appeals by Debtor, by Southern Pacific Company, Intervener, by Horace A. Davis and others as a protective committee for holders of Central Arkansas and Eastern Railroad Company First Mortgage Bonds, Interveners, by Horace A. Davis and others as a protective committee for holders of Stephenville North & South Texas Railway Company First Mortgage Bonds, Interveners, and by Walter E. Meyer, Intervener.[1] These appeals were consolidated and heard upon a single record by the Court of Appeals.

On August 26, 1946, the Circuit Court of Appeals handed down its opinion (R. 5559-5680) affirming the order of the District Court in approving the plan, except for matters not pertinent to this petition, and remanding the case to the District Court for the purpose of amending the plan (R. 5681-5683).

After an order extending the time therefor (R. 5683-5684), petitions for rehearing were filed by the various appellants (R. 5685, 5711, 5767), and on October 22, 1946 were denied (R. 5831).

On November 8, 1946 the Circuit Court of Appeals entered its order staying the mandate for a period of 60 days (R. 5834). Thereafter, upon motion, the mandate was further stayed until January 22, 1947.

The provisions made for the various creditors and stockholders of the Debtor by the modified plan of the Interstate Commerce Commission are set out effectively in the table (R. 3785) therein designated Appendix A. It appears therefrom that the following obligations of the Debtor were left undisturbed: Equipment obligations in the amount of $216,000; First Mortgage Certificates in the amount of $20,000,000; Gray's Point Terminal obligations

1 These appeals were numbered 12882, 12883, 12884, 12885, and 12886, respectively.

in the amount of $500,000; Shreveport Bridge obligations in the amount of $450,000 and Texarkana Union Station certificates in the amount of $315,000. The Railroad Credit Corporation received full recognition of its claim by the allocation of $1,331,300 in ten-year four per cent serial notes. Consolidated Mortgage fifty-year four per cent obligations were issued for the full amount due on the second mortgage certificates and for portions of the claims represented by the First Terminal and Unifying Five's, and General and Refunding Five's and for portions of the claims of Chase National Bank, Mississippi Valley Trust Company and Southern Pacific Company. Five per cent preferred stock was issued for the balance of the claim of the First Terminal and Unifying Five's, and for portions of the balances of the claims of General and Refunding Five's, Chase National Bank, Mississippi Valley Trust Company and Southern Pacific Company. Common stock was issued for the balance of the claim of the General and Refunding Five's, Chase National Bank, Mississippi Valley Trust Company and Southern Pacific Company. Common stock was also issued for portions of the claims of the Stephenville Five's and the Central Arkansas and Eastern Five's. The preferred stock and the common stock of the Debtor were completely eliminated by this plan. The revised plan of the Interstate Commerce Commission, therefore, provided for funded debt in the amount of $37,499,827; five per cent preferred stock in the amount of $18,750,091 and common stock in the amount of $18,749,961, or a total capitalization of $74,999,879.

Before the United States District Court and again before the United States Circuit Court of Appeals the Debtor has consistently contended that the plan proposed by the Interstate Commerce Commission is inequitable for the reason that during the period of time which has elapsed between the filing of the petition herein on December 12, 1935, and

the decision by the District Judge on February 9, 1944, the position of the Debtor had changed from one of insolvency to solvency by a distinct margin. Debtor contended in its appeal that the plan therefore was unjust and inequitable to the stockholders of the Debtor, both common and preferred, in eliminating them completely from the reorganization; that the plan of reorganization should be resubmitted to the Commission for revision in the light of the supervening solvency of the Debtor; that the plan of the Commission gave no consideration to the recent prosperity of the Debtor, the recent accretions to its assets in the form of cash and improvements of the Debtor's financial condition, and the growth in wealth and population of the trade area served by the Debtor; and that the action of the Commission deprived the common and preferred stockholders of the Debtor of their property without due process of law in contravention of the Fifth Amendment to the Constitution of the United States.

The Circuit Court of Appeals discussed these contentions of the Debtor. With regard to the prospective earnings the Circuit Court of Appeals said (R. 5657-5658):

> "The sole cause of these enormous increases is, for the most part if not entirely, the war. This cause was temporary. That the end of hostilities would result in a pronounced decrease to peacetime normalcy is a certainty. * * *"
>
> "It is urged that though there will be a falling off in revenue at the end of the war, yet there will be an increase of business for Debtor over that before war. The argument is that the increase of population into this territory during the war will result in many of these newcomers remaining; and that many of the numerous war industries established there will be converted into peacetime uses. These results may occur but the measure of them is not even estimated. Such uncertain elements can find no place in estimated future earning for reorganization valuation purposes. * * *"

"Whatever may be the effects of these wartime revenues in other relations, they are too abnormal and too temporary to be taken as any gauge of prospective earning of Debtor during the long sweep of years intended by Congress to be planned for in a reorganization proceeding."

With regard to the rise in value the Circuit Court of Appeals had this to say (R. 5662):

"The fact that the physical properties, including cash and liquid securities, may have a value beyond the total indebtedness is not controlling either at the beginning or during such reorganization proceedings. The only place for bettered conditions, after formation of a Plan by the Commission, is where such conditions have so altered the situation as to make the Plan inequitable to existing creditors or stockholders. * * *"

(R. 5663):

"Solvency in the sense of balance of assets over liabilities has small bearing upon such equity.

"The broad question is, do these changed conditions show such inequity in this Plan?"

Later the court makes this comment (R. 5669):

"That these much improved conditions as to cash, liquid assets and potential tax refunds **might** alter the picture as seen by the Commission at the time of its report seems true. However, that they **must** do so because otherwise the sight of the Commission would have to be declared arbitrary, we think is not true."

Petitioner contends that the actual facts now existing in this reorganization are such as to make the Circuit Court of Appeals' doubts about Debtor's future wholly unjustified.

Petitioner submits that the plan recommended by the Commission has become stale and that if equity is to be

done the plan must be re-examined in the light of the drastically changed conditions. We are now in the twelfth year since the date of the filing of the petition by the Debtor. The latest figures which the Interstate Commerce Commission had upon which to base its modified plan were the figures as of December 31, 1941, which figures are now over five years old. These figures reflected none of the tremendous profits made by Debtor during the war period, for the war had commenced only twenty-two days prior to the latest effective date of these figures. Since that time an insolvent corporation has become a solvent corporation by a large margin, giving clear and definite values to the stockholders of the Debtor; yet the plan herein proposed would completely and forever wipe out these definite, real and existing values.

Debtor attaches as Appendix A hereto a table showing the long-term debt, the interest in default and the net current assets of the Debtor as of six dates. The first of these dates is December 31, 1941, the last complete year prior to the promulgation of the modified plan by the Interstate Commerce Commission on March 9, 1942. The next date is December 31, 1943, being the last complete year prior to the United States District Court's approval on February 9, 1944, of the Interstate Commerce Commission's plan of reorganization. The next date is December 31, 1944, being the last complete year prior to the submission of the plan on April 7, 1945, to the United States Circuit Court of Appeals. The next date, December 31, 1945, is included for completeness. The next figures are those of July 31, 1946, which are the latest figures the Court of Appeals could have considered in denying the Debtor's petition for rehearing. The last figures, those of October 31, 1946, are included as the latest available figures. This procedure was accepted by this court in **Ecker v. Western Pacific R. Corp.**, 318 U. S. 448, 507, 87 L. Ed. 892, 949.

An analysis of these figures reveals some startling comparisons. It shows improvement in the Debtor's financial position from the various dates to the present time so pronounced as to take this case out of any of the situations which existed in the cases heretofore decided by this court involving railroad reorganizations, in all of which this court had held that the change in circumstances did not warrant resubmission of the plan, to-wit: **Ecker v. Western Pacific R. Corp.**, 318 U. S. 448, 87 L. Ed. 892; **Group of Institutional Investors v. Chicago, Milwaukee, St. Paul & Pacific R. Co.**, 318 U. S. 523, 87 L. Ed. 959; **R. F. C. v. Denver & Rio Grande Western R. R. Co.**, 90 L. Ed. 1134.

For purposes of convenience petitioner sets forth herein a summary of these changes.

ST. LOUIS SOUTHWESTERN RAILWAY LINES

Improvement in Financial Position from December 31, 1941 (the Last Complete Year Prior to I. C. C. Promulgation of Final Plan on March 9, 1942) to October 31, 1946.

	December 31, 1941	October 31, 1946	Improvement
Long-term Debt	$68,705,399	$67,254,145	$ 1,451,254
Interest in Default	13,862,823	4,690,826	9,171,997
Net Current Assets	8,010,813	22,090,504	14,079,691
Total Improvement			$24,702,942

ST. LOUIS SOUTHWESTERN RAILWAY LINES

Improvement in Financial Position from December 31, 1943 (the Last Complete Year Prior to U. S. District Court's Approval of the I. C. C. Plan of Reorganization on February 9, 1944) to October 31, 1946.

	December 31, 1943	October 31, 1946	Improvement
Long-term Debt	$68,175,434	$67,254,145	$ 921,289
Interest in Default	11,936,783	4,690,826	7,245,957
Net Current Assets	13,440,090	22,090,504	8,650,414
Total Improvement			$16,817,660

ST. LOUIS SOUTHWESTERN RAILWAY LINES

Improvement in Financial Position from December 31, 1944 (the Last Complete Year Prior to Submission of Plan to U. S. Circuit Court of Appeals on April 7, 1945) to October 31, 1946.

	December 31, 1944	October 31, 1946	Improvement
Long-term Debt	$67,866,134	$67,254,145	$ 611,989
Interest in Default	10,056,493	4,690,826	5,365,667
Net Current Assets	14,177,297	22,090,504	7,913,207
Total Improvement			$13,890,863

ST. LOUIS SOUTHWESTERN RAILWAY LINES

Improvement in Financial Position from July 31, 1946 (the Date for Figures Used in Debtor's Petition for Rehearing in the U. S. Circuit Court of Appeals) to October 31, 1946.

	July 31, 1946	October 31, 1946	Improvement
Long-term Debt	$67,636,394	$67,254,145	$ 382,249
Interest in Default	4,190,921	4,690,826	—499,905
Net Current Assets	20,476,594	22,090,504	1,613,910
Total Improvement			$ 1,496,254

It will thus be seen that from December 31, 1941 (the date of the latest figures available to the Interstate Commerce Commission) to the present time, the financial position of the Debtor has changed for the better by $24,702,942. Bearing in mind that the total capitalization contemplated by the Interstate Commerce Commission plan is approximately $75,000,000, it is apparent that the improvement in Debtor's cash position since the formulation and promulgation of the plan is one-third the amount of the total contemplated capitalization.

From December 31, 1943 (the last full year prior to the District Court's approval) until the present time, the financial position of the Debtor has improved by $16,817,660. From December 31, 1944 (the last complete year prior to submission of the plan to the United States Circuit Court of Appeals) to the present time, the financial position of the Debtor has improved by $13,890,863. From July 31, 1946, the date of the figures used in Debtor's petition for rehear-

ing in the United States Circuit Court of Appeals, to October 31, 1946 (the date of the latest available figures), the improvement in financial position has been $1,496,254.

The improvement in the Debtor's cash asset position in the last mentioned amount for three months indicates that the Debtor's financial position is currently improving at the rate of almost $6,000,000 per year.

Bearing in mind that V-J Day occurred in August of 1945, the figures showing the improvement between July 31, 1946 and October 31, 1946, are highly significant in that they show financial improvement at the rate of approximately $6,000,000 a year more than one full year after the actual termination of the war.

There is submitted with this petition as Appendix B thereto the general balance sheet of the Debtor Company as of October 31, 1946 (eliminating inter-company items).

Supplementing the astonishing revelations made by the figures hereinabove cited with reference to decrease in funded debt and over-due interest unpaid and the increase in net current assets, is the increase in the account of Debtor's property devoted to railway service. Despite substantial abandonments of unprofitable lines, and in the face of the Trusteeship, Debtor's investment in road and equipment has continued to grow as follows:

Road and Equipment Property (Including Improvements on Leased Railway Property) as of Various Dates.

Date	Page of Record	Amount
December 31, 1941	5259	$124,808,960
December 31, 1943	5259	$128,465,630
December 31, 1944	5259	$132,647,575
December 31, 1945	5694	$136,493,793
October 31, 1946	Note	$136,577,314

Note: See Appendix B to this Petition.

From December 31, 1941 (the year end nearest to the Commission's promulgation of the plan of reorganization on March 9, 1942) to December 31, 1943 (the year end nearest the District Court's confirmation of this plan of February 9, 1944) Debtor's investment in road and equipment had risen from $124,808,960 to $128,465,630, an increase of $3,656,670. From December 31, 1941 to December 31, 1944 (the year end nearest to the submission to the Court of Appeals on April 7, 1945) Debtor's road and equipment account had risen from $124,808,960 to $132,647,575, an increase of $7,838,615. From December 31, 1941 to the latest available date, October 31, 1946, Debtor's road and equipment account had risen from $124,808,960 to $136,577,314, or an increase of $11,768,354.

These increases in investment in road and equipment are proper additions to the improvement in the financial position of the Debtor for the dates in question.

Based upon all of the foregoing, the total improvement in property and financial situation of the Debtor from December 31, 1941 to October 31, 1946 has been $36,471,296 as indicated by the table hereinafter set forth:

	December 31, 1941	October 31, 1946	Improvement
Long-term Debt	$ 68,705,399	$ 67,254,145	$ 1,451,254
Interest in Default	13,862,823	4,690,826	9,171,997
Net Current Assets	8,010,813	22,090,504	14,079,691
Road & Equip. Property	124,808,960	136,577,314	11,768,354
Total Improvement in Property and Financial Situation			$36,471,296

It is apparent, therefore, that since the Interstate Commerce Commission evolved a plan fixing the total capitalization of the Debtor Road at approximately $75,000,000, there has been a total improvement in property and financial situation of the Debtor Road of more than $36,000,000; in other words, of almost one-half of the total authorized

capitalization set up by the Interstate Commerce Commission.

Obviously, such a definite and unquestionable financial improvement in the Debtor Road presents a situation for the consideration of this court which has never heretofore been before it.

The Commission appraised the Debtor's road and equipment as of December 31, 1935 at $68,523,903 and found that deferred maintenance amounting to $3,173,500 had accumulated (R. 260-262; 3499-3502). The undisputed testimony of Colonel Green, Chief Operating Officer for the Trustee of the Debtor, offered and received at the hearing before the District Court in October, 1942, completely disposes of the item of deferred maintenance. He testified that he had been connected with the Debtor since the year 1916; that since the appointment of the Trustee he had been with the Trustee continuously in the operation of the railroad and that he had charge of the construction, engineering, transportation, mechanical, maintenance of way and certain minor departments (R. 4147-4148). This witness testified that between January 1, 1936 and January 1, 1942 this item of deferred maintenance ($3,173,500) "has all been wiped out; no longer exists" (R. 4149-4151). It is submitted, therefore, that the reason given by the Commission for this item of depreciation did not exist at the time of the hearing in the District Court.

It may be admitted that Debtor was insolvent, in the bankruptcy sense of the word, at the time the petition was filed in the District Court on December 12, 1935. At the time the Commission approved a plan of reorganization it found that debt claims totalling $8,304,118 could receive no recognition within the limits of capitalization approved (R. 3700). In other words, the Commission found that as

of March 9, 1942, Debtor had liabilities exceeding its assets of $8,304,118. The latest figures the Commission had before it were those of December 31, 1941. At this time (December 31, 1941) the net current asset balance of Debtor was $8,010,813 (R. 5259, 5261), and its long-term debt and accrued interest amounted to $82,568,222 (R. 5259-5261).

As of December 31, 1944, the net current asset balance was $14,177,297 and the total long-term debt and accrued interest in default was $77,922,627. The improvement, therefore, during this period of time was $10,812,079. Therefore, the insolvency of $8,304,118 had been entirely wiped out and debtor was then solvent by approximately $2,500,000. As shown by the figures hereinabove set forth, as of October 31, 1946, the comparable net current asset balance was $22,090,504.54 and the long-term debt and accrued interest in default was $71,944,971.96. This represents an improvement over the figures considered by the Commission of $24,702,942. Debtor, therefore, was solvent as of October 31, 1946 by a margin of approximately $16,400,000.

Petitioner attaches as Appendix C hereto, the income account of Debtor for the first ten months of 1946. This shows a net income for these ten months of $3,446,085.12. A projection of this net income would indicate an annual net income for the year 1946 of $4,135,302.14. Appendix C shows the income available for fixed charges for the first ten months of 1946 to be $5,949,631.47. Projecting this figure on a yearly basis, it would appear that the income available for fixed charges this year would be approximately $7,139,557.76. Footnote 17 to the Circuit Court of Appeals opinion (R. 5657) shows the income available for fixed charges from the years 1923 through 1944. It is highly significant to note that during the entire period preceding the year 1941 at no time did this figure exceed

the 1923 figure of $5,929,628. Looking at the period from 1930 to 1940 the highest figure for any one year was the figure of $3,333,243 for the year 1936. It will be noted that the estimated income available for fixed charges during 1946 is more than twice this figure. The 1946 figure is approximately six times the low figures appearing during the ten-year period from 1930 to 1940. The significance of this comparison is apparent from the fact that this is the period upon which the Interstate Commerce Commission largely relied in reaching its conclusions (R. 3504).

According to the plan of the Interstate Commerce Commission, the annual charges ahead of common stock consist of $1,513,723 interest and $937,505 in preferred stock dividends, or a total of $2,451,228. The estimated income available for fixed charges for the year 1946 is approximately three times this amount. Certainly this is a comfortable margin of income over and above the requirements of the proposed capitalization of the Debtor Railroad.

Moreover, these figures prove unjustified the pessimism of the Circuit Court of Appeals which predicted a decrease to "peacetime normalcy" (R. 5658).

There is every reason to expect that these net profit figures will continue to be greatly in excess of the requirements of the proposed capitalization. The court can and will take judicial notice of the extensive population increase and industrial development in the geographical area served by the Debtor Railroad.[2]

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2 The population of Los Angeles as of January, 1946 was 1,805,687, an increase of 20 per cent since April 1, 1940 (Census Bureau Report, Series P-SC No. 119, April 10, 1945). Houston, Dallas and Ft. Worth have grown from 1940 census figures of 384,514, 294,734 and 177,662, respectively, to 478,000, 425,000 and 235,000. The total California population increase from April 1, 1940 to July 1, 1945 was 27.7 per cent. The total Texas population increase between April 1, 1940 and July 1, 1945 was 5.8 per cent (Census Bureau Report Series P-46, No. 3). The total population of the United States as a whole during the same period increased only .2 per cent.

Moreover, considerably augmented gross revenues and attendant net revenues will be derived as a result of the order of the Interstate Commerce Commission made December 5, 1946 in Ex Parte No. 162, Increased Railway Rates, Fares and Charges, 1946, and Ex Parte No. 148, Increased Railway Rates, Fares and Charges, 1942. The effect thereof is an increase in basic freight rates of 20 per cent for the future and the continuation of previously granted passenger fare increases.

With present unquestioned solvency of the Debtor and with a new post-war level of revenues established, it is inescapable that the plan based on figures now more than five years old is inequitable and should not be sustained.

JURISDICTION.

The final judgment of the Circuit Court of Appeals was entered August 26, 1946 (R. 5681). On September 9, 1946, the said court issued an order extending to September 25, 1946 the time for filing petitions for rehearing, which time would otherwise have expired September 10, 1946 (R. 5683, 5684). Petitioner filed its petition for rehearing on September 25, 1946 (R. 5710). This petition was denied by the Court of Appeals October 22, 1946 (R. 5831).

Jurisdiction of this court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925 (28 U. S. C. Sec. 347 [a]) and under Section 24 of the Bankruptcy Act, as amended June 22, 1938 (11 U. S. C. Sec. 47).

This court's jurisdiction is supported by the following cases:

Ecker v. Western Pacific R. Corp., 318 U. S. 448, 87 L. Ed. 892;

Group of Investors v. Milwaukee R. Co., 318 U. S. 523, 87 L. Ed. 959;
R. F. C. v. Denver & Rio Grande Western R. R. Co., 90 L. Ed. 1134.

THE QUESTIONS PRESENTED.

The questions presented are:

1. Whether an Interstate Commerce Commission plan can be sustained as equitable which completely excludes the interests of the stockholders of Debtor from participation, where, as of the present time, the Debtor is solvent by a distinct and unquestionable margin?

2. Whether Debtor's present solvency may be ignored and all of the stockholders' real and valuable interests be wiped out merely because the Interstate Commerce Commission found almost five years ago that there were no equities?

3. Whether a plan which destroys the obvious values of stockholders and excludes them from any future interest or participation in the future development of the company is "fair and equitable," or "affords due recognition to the rights of each class of creditors and stockholders," or "does not discriminate unfairly in favor of any class of creditors or stockholders," or "will conform to the requirements of the law of the land regarding the participation of various classes of creditors and stockholders," as required by Section 77 of the Bankruptcy Act?

4. Whether to deprive stockholders of their legal property, viz., proprietary interests in a corporation, now solvent by a wide margin, does not violate Amendment V to the United States Constitution and amount to a deprivation of property without due process of law?

5. Whether an Interstate Commerce Commission plan can be sustained as equitable when the plan was based on the Debtor's pre-war peacetime level although the Debtor's established post-war peacetime level is considerably higher?

6. Whether in determining the prospective earnings of the property of Debtor, present earnings may be disregarded and the equities of the stockholders be held without value because of consideration only of the diminished earnings during the period of national receding economy and depression?

REASONS RELIED ON FOR THE ISSUANCE OF A WRIT OF CERTIORARI.

1. The Circuit Court of Appeals has decided an important question of Federal law which has not been, but should be, settled by this court, namely, whether a plan promulgated by the Interstate Commerce Commission can be sustained as equitable which completely excludes the stockholders of the Debtor from participation therein although complete solvency now exists by a wide margin.

2. The Circuit Court of Appeals has decided an important question of Federal law which has not been, but should be, settled by this court, namely, whether a plan promulgated by the Interstate Commerce Commission can be sustained as equitable which completely excludes stockholders of the Debtor from participation therein, the plan having been formulated on the basis of pre-war peacetime earnings when the established post-war peacetime earnings are greatly in excess thereof, being from one to six times the annual amounts thereof.

3. The Circuit Court of Appeals has decided a Federal question in a way probably in conflict with applicable

decisions of this court. The decision of the Court of Appeals excluding the stockholders of the Debtor from participation in the reorganization in the face of undenied solvency of the Debtor and in the face of unquestioned post-war peacetime earnings greatly in excess of the pre-war peacetime earnings upon which the reorganization was predicated, is probably in conflict with the following decisions of this court:

Ecker v. Western Pacific R. Co., 318 U. S. 448, 87 L. Ed. 892;
Group of Investors v. Milwaukee R. Co., 318 U. S. 523, 87 L. Ed. 959;
R. F. C. v. Denver & Rio Grande Western R. R. Co., 90 L. Ed. 1134.

4. The Circuit Court of Appeals has decided a Federal question in a way probably in conflict with the applicable decisions of this court, in sustaining a plan of reorganization which completely excludes stockholders from participation therein and thereby deprives them of their property without due process of law in contravention of the provisions of Amendment V to the Constitution of the United States. The applicable decisions are:

Group of Investors v. Milwaukee R. Co., 318 U. S. 523, 87 L. Ed. 959;
Kuehner v. Irving Trust Company, 299 U. S. 445, 81 L. Ed. 340;
Louisville Joint Stock Land Bank v. Radford, 295 U. S. 555, 79 L. Ed. 1593.

5. The Circuit Court of Appeals has rendered a decision in conflict with the decision of another Circuit Court of Appeals on the same matter, namely, the decision of the Circuit Court of Appeals for the Second Circuit in the case of **Adelaide H. Knight and William P. Doyle v. Wertheim & Co., et al.** (Decided December 31, 1946: Docket No.

20349). That case, a corporate reorganization under Chapter X of the Bankruptcy Act, came to the Court of Appeals on appeal from an order of the District Court denying a motion to amend a plan of reorganization after confirmation. The Court of Appeals reversed the District Court because of the unforseen changed financial conditions occurring after the confirmation. It held that the protection of the existing equities was more important than speed in the reorganization, and further that these equities belong to the stockholders and not to the other security holders. (Said opinion is attached hereto as Appendix D.)

PRAYER.

For the foregoing reasons, which are developed in further detail in the accompanying brief, your Petitioner prays that a writ of certiorari issue out of this Court to the United States Circuit Court of Appeals for the Eighth Circuit commanding said court to certify and send to this court on a day to be determined, a full and complete transcript of the record of all of the proceedings of such Court had in this cause, to the end that this case may be reviewed and determined by this Court; that the final order and decree of the said United States Circuit Court of Appeals be reversed, and that this Petitioner be granted such other and further relief as is proper.

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Railway Company, a corporation,
Debtor, Petitioner.

IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1946.

ST. LOUIS SOUTHWESTERN RAILWAY COMPANY,
a Corporation, Debtor,
Petitioner,

vs.

BERRYMAN HENWOOD, as Trustee of ST. LOUIS SOUTHWESTERN RAILWAY COMPANY LINES, et al.,
Respondents.

BRIEF

In Support of Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Eighth Circuit.

OPINIONS BELOW.

The opinion of the United States District Court for the Eastern District of Missouri (R. 5183-5213) is reported in 53 Fed. Supp. 914. The opinion of the United States Circuit Court of Appeals (R. 5559-5683) is reported at 157 Fed. (2d) 337.

JURISDICTION.

The final judgment of the Circuit Court of Appeals was entered August 26, 1946 (R. 5681). On September 9, 1946, the court issued an order extending to September 25, 1946 the time for filing petitions for rehearing, which time would otherwise have expired September 10, 1946 (R. 5683, 5684). Petitioner filed a petition for rehearing on September 25, 1946 (R. 5710). This petition was denied by the Court of Appeals October 22, 1946 (R. 5831).

Jurisdiction of this court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925 [28 U. S. C. Sec. 347 (a)] and under Section 24 of the Bankruptcy Act, as amended June 22, 1938 (11 U. S. C. Sec. 47).

This court's jurisdiction is supported by the following cases:

Ecker v. Western Pacific R. Corp., 318 U. S. 448, 87 L. Ed. 892;
Group of Investors v. Milwaukee R. Co., 318 U. S. 523, 87 L. Ed. 959;
R. F. C. v. Denver & Rio Grande Western R. R. Co., 90 L. Ed. 1134.

STATEMENT.

For the sake of brevity we refer to the Summary Statement of the Matter Involved, contained in the petition.

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED.

Constitution of the United States of America, Amendment V:

> "No person shall be held to answer for a capital or otherwise infamous crime unless on a presentment or indictment of a grand jury, except in cases arising in the land or naval forces, or in the militia, when in actual service in time of war or public danger; nor shall any person be subject for the same offense to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty or property without due process of law; nor shall private property be taken for public use without just compensation."

Section 77 (c) of the Bankruptcy Act is here involved. Because of its length, it is reproduced as Appendix E hereto.

SPECIFICATION OF ERRORS TO BE URGED.

The Circuit Court of Appeals erred:

I. In holding the reorganization plan of the Interstate Commerce Commission to be equitable although said plan excluded Debtor's stockholders entirely from participation therein, when, in the interim between the plan's approval by the Commission and the decision, the Debtor had ceased to be insolvent and has become solvent by a wide margin.

II. In holding the reorganization plan of the Interstate Commerce Commission to be equitable, even though it excluded the Debtor's stockholders from participation therein, when the plan was formulated on the theory that the Debtor's post-war peacetime earnings would not exceed Debtor's pre-war peacetime earnings, even though at the time of the decision by the Court of Appeals these earnings were proven to be much greater.

III. In ignoring the provisions of Amendment V to the Constitution of the United States, which provide that no person shall be deprived of property without due process of law and that private property shall not be taken for public use without just compensation, by sustaining a plan of reorganization which completely excludes stockholders from participation therein at a time when the unquestioned records of Debtor show that such stockholders have a very definite equity in the corporation.

SUMMARY OF ARGUMENT.

The argument will follow the foregoing specifications of errors to be urged.

ARGUMENT.

I.

The Circuit Court of Appeals Erred in Holding the Reorganization Plan of the Interstate Commerce Commission to Be Equitable Although Said Plan Excluded Debtor's Stockholders Entirely From Participation Therein, When, in the Interim Between the Plan's Approval by the Commission and the Decision, the Debtor Had Ceased to Be Insolvent and Has Become Solvent by a Wide Margin.

For the purposes of this writ, Petitioner will not question the correctness of the plan formulated by the Interstate Commerce Commission based on the evidence before it at that time. The Debtor had filed its petition for reorganization on December 12, 1935. The Commission had commenced hearings and had concluded them on April 24, 1937. On January 10, 1939, it reopened the hearings and did not conclude them until September 30, 1939. The final submission before the Commission was October 3, 1940. On June 30, 1941, the Report and Order of the Interstate Commerce Commission was filed (249 I. C. C. 5). Thereafter, on March 9, 1942, a modified Report and Order of the Interstate Commerce Commission was filed (252 I. C. C. 325). The plan of reorganization, therefore, which the Interstate Commerce Commission formulated was predicated entirely upon the figures of the period ending not later than December 31, 1941. Obviously the full effect of the tremendously increased war earnings had not yet been felt because Pearl Harbor Day had been only three weeks prior thereto.

Subsequent thereto, the Debtor has made great improvements in its financial position, it has accumulated

net current assets of $22,090,504, it has a total surplus of $35,354,529.79, and it has passed from a position of insolvency to a position of unquestioned solvency by an unquestionable margin.

Under the circumstances, the plan as formulated by the Commission and as sustained by the District Court and by the Circuit Court of Appeals has become grossly inequitable and cannot in good conscience be sustained.

This court has had before it in recent years three cases involving railroad reorganization, towit: **Ecker v. Western Pacific R. Corp.**, 318 U. S. 448, 87 L. Ed. 892; **Group of Investors v. Milwaukee R. Co.**, 318 U. S. 523, 87 L. Ed. 959; **R. F. C. v. Denver & Rio Grande Western R. R. Co.**, 90 L. Ed. 1134. In each of these cases, the Supreme Court has taken cognizance of the fact that a change in financial conditions subsequent to the formulation of a plan might render the plan inequitable.

In the case of **Ecker v. Western Pacific R. Corp.**, 318 U. S. 448, 87 L. Ed. 892, the Court said, l. c. 507, 949:

> "Respondents ask us to take into consideration the changed conditions since the Commission acted."

The Court then proceeded to consider the changed conditions without questioning in any respect the propriety of doing so. By stipulation of the parties, reports of operating results, combined, had been filed for the period from December, 1938, to July, 1942. The case was argued in the Supreme Court October 13, 1942. Quoting further, l. c. 508, 950:

> "In the interest of advancing the solution of as many problems in reorganization as possible, we have deliberated upon the effect to be given these unexpectedly large earnings. * * * Already serious proposals for decrease of tariffs have been advanced.

> • • • The Commission's forecast was made with knowledge of and not in disregard of past fluctuations of income, in war and in peace. On the showing as to changed conditions made before the District Court, there was no basis for a disapproval of the Commission plan as unfair to junior equities. The further evidence of increased earnings, placed in the record by the stipulations, does not lead us to reject the Commission's plan."

In **Group of Investors v. Milwaukee R. Co.**, 318 U. S. 523, 87 L. Ed. 959, the court stated, l. c. 542, 995:

> "The question of the increase in earnings since the Commission approved the plan raises of course different issues. As we have indicated in the Western R. Corp. Case, the power of the District Court to receive additional evidence may aid it in determining whether changed circumstances require that the plan be referred back to the Commission for reconsideration. • • •".
>
> "We agree with the Circuit Court of Appeals that no sufficient showing of changed circumstances has been made which requires the District Court to return the plan to the Commission for reconsideration. • • •".

L. c. 544, 996:

> "In view of these considerations we cannot say that the junior interests have carried the burden which they properly have of showing that subsequent events made necessary a rejection of the Commission's plan."

In the latest pronouncement upon this problem in the case of **R. F. C. v. Denver & Rio Grande Western R. R. Co.**, 90 L. Ed. 1134, this court said, l. c. 1143:

> "Changes in economic conditions cannot affect the powers of the reorganization agencies even though such changes may require a reexamination into the present fairness of the former exercise of these powers."

Again, l. c. 1148, the court said:

> "Assuming that the courts, as courts with equity powers in a bankruptcy matter, might set aside a plan, fair and equitable when adopted by the Commission, merely on account of subsequent changes in economic conditions of the region or the Nation, it should not be done when the changes are of the kind that were envisaged and considered by the Commission in its deliberations upon or explanation of the plan."

L. c. 1155:

> "Of course, this does not mean that if a plan is approved as fair and equitable by the Commission and the court, there cannot be a reasonable justification for its rejection by a class of claimants on submissions. **Reasons to make their objection reasonable may arise thereafter. For example, unanticipated, large earnings, might develop.**" (Emphasis supplied.)

It is thus obvious that this court has not in any of its railroad reorganization cases doubted for a moment the propriety of considering changed circumstances arising after the formulation and submission of the plan of reorganization.

This disposition of the Supreme Court is entirely consistent with its holdings in similar previous situations. In the case of **Central Kentucky Natural Gas Company v. Railroad Commission of Kentucky et al.**, 290 U. S. 264, 78 L. Ed. 307, the District Court had denied an injunction against rates prescribed by the State Railroad Commission for the sale of natural gas, which rates had been found to be confiscatory, because of plaintiff's failure to conform to a condition prescribed by the court as a prerequisite to the granting of the injunction. The rate was based upon a valuation as of December 31, 1926, although the case was not ready for a final decree until

September, 1932. The court mentioned some items of additional cost to plaintiff since that time and said, l. c. 274, 314:

> "That restriction also necessarily excluded from consideration the profound change in values, costs of service, consumption of commodities and reasonable return on invested capital which we judicially know took place during the period of more than five years while the case was pending before the Commission and the court. It is apparent that any decree, to be entered here, upon findings so restricted, must be similarly restricted in its operation and should speak of the validity of the Commission's rate only as of a time approximating the date when the franchise became effective. * * * The decree will state * * * that it makes no adjudication of the validity of the forty-five cent rate fixed by the Commission, so far as it may be affected by changed conditions after February 27, 1927, the effective date of appellant's franchise."

A similar instance of the consideration given by this court to changed conditions is found in the case of **A. T. & S. F. Railway Company et al. v. U. S., I. C. C., et al.**, 248 U. S. 248, 76 L. Ed. 273. Plaintiffs appealed from an order of the District Court denying the application for an interlocutory injunction against the enforcement of a rate order of the Interstate Commerce Commission. The record had been closed September 22, 1928. The matter had been submitted July 1, 1929. The order of the Interstate Commerce Commission was entered July 1, 1930. On February 18, 1931, the second petition for rehearing based upon economic changes was sustained and the order was amended April 10, 1931. This court there said, l. c. 260, 280:

> "It [the second petition for rehearing] was of the nature of a supplemental bill. It presented a new situation, a radically different one, which had super-

vened since the record before the Commission had been closed in September, 1928. * * *

"There can be no question as to the change of conditions upon which the new hearing was asked. Of that change we may take judicial notice. It is the outstanding contemporary fact, dominating thought and action throughout the country.

"It is plain that a record which was closed in September, 1928, relating to rates on a major description of the traffic of the carriers in a vast territory cannot be regarded as representative of the conditions existing in 1931. That record pertains to a different economical era and furnishes no adequate criterion of present requirements.

"In justification of this course [referring to the action of the Interstate Commerce Commission] it is urged on behalf of the Commission that its determination had been reached after regularly conducted and protracted hearings in which carriers and shippers had cooperated * * * and that a reopening would have meant further lengthy proceedings. It is said that 'in performing its legislative function of prescribing reasonable rates, the Commission necessarily projects into the future the results of a decision based on the conditions disclosed in the record' and that its determination 'cannot reflect accurately fluctuating conditions'. These suggestions would be appropriate in relation to ordinary applications for rehearing, but are without force when overruling economic forces have made the record before the Commission irresponsive to present conditions. This is not the usual case of possible fluctuating conditions but of a changed economic level and the prospect that a hearing may be long does not justify its denial if it is required by the essential demands of justice."

The cause was remanded to the District Court with directions to grant the injunction as prayed.

The language of the last quoted case is especially applicable to the instant problem. In connection with the finan-

cial condition of the Debtor now as compared with its condition at the time of the promulgation of the Commission's plan, we are not dealing with a mildly fluctuating condition **but with a definitely changed economic level.** This applies equally to the Debtor and to economic conditions generally in the region in which the Debtor operates. **The Debtor has passed from insolvency to solvency.** The post-war peacetime earnings are considerably higher than the pre-war peacetime earnings and the economic developments in the territories served by Debtor, coupled with the increased authorized freight rates, are bound to establish new economic peacetime levels for Debtor never before known.

As set out by Petitioner heretofore in its petition for the writ of certiorari, one very definite reason for this court granting the writ as prayed is that a question of Federal law, vitally important to the issues in the administration of railroad reorganizations under Section 77, is presented which has not been, but should be, settled by this court, namely, can a plan excluding stockholders be sustained as equitable **where the Debtor is solvent?**

In none of the other cases considered by this court, i. e., the **Western Pacific**, the **Milwaukee** and the **Denver & Rio Grande Western** cases, supra, has a situation been presented even remotely approaching the present problem. None of these roads was solvent at the time of the decision.

In the case of **Ecker v. Western Pacific R. Corp.**, supra, the petition for reorganization was filed in August, 1935. The Interstate Commerce Commission certified its plan in September of 1939. The District Court approved the plan; this court reversed the Circuit Court of Appeals in its reversal of the District Court. The stockholders of the Debtor were completely eliminated in the reorganization on the basis of the finding of the Commission that the stock

was valueless. There was no point made, and the record clearly showed that no point could be made, of any alleged solvency of the Debtor corporation. The language of the court indicated that there was actual bankruptcy and therefore the denial of any participation to the stockholders was justified. The following language appears in the opinion, l. c. 475, 933:

> "Assuming at this point that the Commission's valuation is sound and reached by allowable methods, a matter discussed later in this opinion, we hold that the elimination of the claims of stockholders and creditors which are valueless from participation in the reorganizations is in accordance with the valid provisions of Section 77 (e). **Actual bankruptcy** means a loss to some investors. Subsection (e) recognizes this inevitable result and provides a method for their elimination from the reorganization proceedings." (Emphasis supplied.)

Here, however, where there is no "actual bankruptcy," but the opposite, the investors should not be called upon to suffer a loss.

In the **Ecker** case this court indicates clearly the emphasis which it places upon the rights of stockholders. It says, l. c. 477, 934:

> "Stock which has no retirement provisions is the backbone of a corporate structure."

One of the cardinal considerations in a reorganization of a debtor railroad is the welfare of the public. This court has said that it is important that the stock of a properly reorganized railroad should have value and should enjoy the confidence of the nation. It is submitted by Petitioner that it would be exceptionally harmful to the position hereafter to be enjoyed by the nation's carriers if, in the face of absolute and unquestioned solvency, and clear and unquestionable stock values, as here presented, these values

can be completely wiped out by the affirmance of an arbitrary reorganization plan.

The second railroad reorganization case decided by this court is that of **Group of Investors v. Milwaukee R. Co.**, 318 U. S. 523, 87 L. Ed. 959. In that case the petition was filed in 1935 and the hearings were closed before the Interstate Commerce Commission in 1938. The Commission approved a plan in 1940. The District Court, after a hearing upon this plan, approved it in 1940, having before it the figures for the first half of the year 1940. The Circuit Court of Appeals reversed the District Court on the ground that the Commission had not made the findings required by the DuBois case[3] as to values. The reorganization plan in this case also eliminated the stockholders. Mr. Justice Douglas, in his opinion, l. c. 541, 995, made the following statement:

> "The finding of the Commission affirmed by the District Court under Section 77 (e) that the stock had no value is supported by evidence. The issue involved in such a determination is whether there is a reasonable probability that the earning power of the road will be sufficient to pay prior claims of interest and principal and leave some surplus for the service of the stock."

On the subject of the changed conditions since the formulation of the plan, the court says, l. c. 543, 995:

> "Late in 1939 the Commission had occasion to say, 'We know from past experience that the upswing in business which war brings is temporary and likely to be followed by an aftermath in which conditions may be worse than before.'"

The court then made reference to the Milwaukee's net operating income in the light of the last World War. These

3 Consolidated Rock Products Co. v. DuBois, 312 U. S. 510, 85 L. Ed. 982.

figures were as follows: 1916, $31,000,000; 1917, $21,500,000; 1918, $4,000,000; 1919, $2,000,000; 1920, more than a $14,000,000 deficit.

In a great many ways this last mentioned case is distinguishable from the instant case. First, there was no contention made and no possibility of contending that the Milwaukee Railroad was solvent. Second, there was no showing and no contention made that there was a "reasonable probability" that the earning power of the road would be "sufficient to pay prior claims of interest and principal and leave anything for the servicing of the stock." Third, the history of the Milwaukee road after the last war was decidedly different from that of the Cotton Belt. The comparable net railway operating income for the Cotton Belt (R. 5657) was as follows: 1917, $6,327,552; 1918, $3,320,342; 1919, $1,516,841; 1920, $4,511,938. The Cotton Belt continued at figures ranging from a high of $5,630,285 in 1923 to a low of $2,219,328 until 1932, when it showed a $196,791 deficit.

The third and most recent railroad reorganization case decided by this court is that of **R. F. C. v. Denver & Rio Grande Western R. R. Co.**, 90 L. Ed. 1134. In that case the petition for reorganization was filed in November of 1935, and it was not until June of 1943 that the Interstate Commerce Commission approved a plan. After one class of creditors had rejected it, the District Court affirmed the plan in October of 1943, holding that the rejection was not reasonably justified. In that case the creditors with secured claims against the reorganized roads were left undisturbed or allocated new securities of the new company. The plan completely eliminated unsecured claims and stockholders. The reversal by the Circuit Court was on the basis that the general bondholders were reasonably justified in rejecting the plan because the free cash in excess of operating capital needs and large earnings from war

business after the date of the plan, should be for the benefit of the general bondholders.

In that case the court, in commenting upon the power of Congress to authorize the Interstate Commerce Commission to eliminate valueless claims, said, l. c. 1041:

> "Liquidation in depression periods meant that large portions of debt, as well as stock interests in the properties would be irretrievably lost to their holders, while reorganization on a capitalization estimated what normal income would support meant the salvage of sound values."

Certainly if Congress was attempting to eliminate the unnecessary hardship attendant upon liquidation in depression periods, it was also the intent of Congress that the reorganization be made on the basis of normal earnings and not earnings of the depression period. To consider only the depression earnings, as the Circuit Court of Appeals did in the instant case, is in effect to give the stockholders no more than if the liquidation had been carried out in 1935 when the petition for reorganization was filed. This is exceptionally objectionable in view of the presently existing solvency of the Debtor road.

The **Rio Grande** case is clearly distinguishable from the instant case in many respects. In the first place, the condition of the Rio Grande made no near approach to solvency, whereas the Cotton Belt has become solvent by approximately $16,400,000. In the second place, the plan in the Rio Grande case was not formulated until June of 1943, after more than a year and a half of actual wartime operations, so that the Interstate Commerce Commission clearly had before it the figures of increased earnings and bettered cash position; in the Cotton Belt case the plan was formulated in March of 1942, only a few months after the commencement of hostilities. The fact that the Su-

preme Court considered this point in the **Rio Grande** case is demonstrated by that portion of its opinion hereinafter quoted, l. c. 1145:

> "We note also the contention that the possibility of a National income much higher and interest rates much lower than before World War II would affect valuation based on prospective earnings. Those factors, we think, were before the Commission when it made its earnings estimate."

In all of these decisions this court has pointed out that the reorganization plans cannot be made on the basis of any rigid mathematical formula, but must represent the best judgment of the Interstate Commerce Commission based upon its qualified and thorough investigation. The court has indicated that it is its function to keep the plans of the Commission within legal limits. That means that the Commission's plans may not be so conservative as to be inequitable under Section 77. The Commission is not called upon to formulate a plan which is absolutely and under all circumstances foolproof. A very pertinent statement to this effect is made by this court in the **Rio Grande** case, l. c. 1155:

> "These respondents cannot be called upon to sacrifice their property so that a depression-proof railroad system might be created."

The St. Louis Southwestern Railway Company, Debtor, is unquestionably solvent today. Its stock has a very real and substantial value. It is helpful to re-examine the provisions of Section 77 to determine whether under these circumstances a plan may be upheld which ignores and destroys these values.

Subsection (b) of Section 77 places a limit upon fixed charges as follows:

> "(b) A plan of reorganization * * * (4) shall provide for fixed charges * * * in such an amount that, after due consideration of the probable prospective earnings of the property in the light of its earnings experience and all other relevant facts, there shall be adequate coverage of such fixed charges by the probable earnings available for the payment thereof."

There is no positive direction in this section to destroy the rights of stockholders; that is left to the discretion of the Commission, subject to legal limitations. The only mandate of the statute relates to the fixed charges; and there again no guarantee of infallibility is exacted of the Commission. The Commission is directed to consider the "probable" prospective earnings of the property, not the "minimum possible" earnings of the property. The "probable prospective earnings" are to be determined in the light of both the "earnings experience" and "all other relevant facts." Certainly the earnings experience of the Debtor Railroad justifies consideration of stockholders in the reorganization plan. The term "all other relevant facts" would certainly include a consideration of the solvency of the Debtor Road.

By Subsection (e) of Section 77, the District Court must be satisfied that the plan is "fair and equitable"; that it "affords due recognition to the rights of each class of creditors and stockholders"; that it "does not discriminate unfairly in favor of any class of creditors or stockholders"; and that it "will conform to the requirements of the law of the land regarding the participation of various classes of creditors and stockholders."

Can a plan be said to be "fair and equitable" which deprives stockholders of their clear and established rights? Can a plan be said to "afford due recognition to the rights of each class of stockholders" which destroys

rather than recognizes these rights? Can a plan be said "not to discriminate in favor of any class of creditors" when in the reorganization it completely excludes definite values and in effect transfers these values to creditors already amply provided for? And finally, can a plan be said "to conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders," which violates the laws of the land by destroying those rights?

In Subsection (e) of said Section 77 the following direction is given with regard to the ascertainment of value:

> "The value of any property used in a railroad operation shall be determined on a basis which will give due consideration to the earning power of the property past, present and prospective, and all other relevant facts. In determining such value only such effect should be given to the present cost of reproduction new and less depreciation and original cost of the property, and the actual investment therein, as may be required under the law of the land, in light of its earning power and all other relevant facts."

It is significant that the word "power" appears in connection with the word "earning." In other words, the value of the railroad is not to be determined upon the basis of earnings, but on the basis of the potentialities of earnings. In the case of a utility whose rates are controlled by regulation, its earning power might be and often is considerably in excess of its actual earnings at any given time.

Moreover, the earning power which must be considered in determining value, according to the letter of the statute, is the "past, present and prospective" earning power. However, in the instant case the Circuit Court of Appeals would ignore the present earning power and the earning power for all of the war years entirely, brushing it aside

as unimportant, in clear violation of the express mandate of the statute. The Circuit Court of Appeals would ignore the prospective earning power of the Debtor Railroad in the light of changed economic and financial conditions and would interpret everything in the light of the unfortunate years of the depression era.

Furthermore, this "value" must, according to the statute, give consideration not only to the earning power of the property, but to "all other relevant facts." What could be more relevant than the supervening solvency of the Debtor corporation?

The effect of the decision of the Court of Appeals would be the same as to say that a man apparently dead who, while being prepared for burial, demonstrates clearly that he is alive, must nevertheless be buried because of the "irrelevancy" of his being alive.

As was pointed out in the petition for certiorari, the Debtor Road was found by the Commission to be insolvent by the amount of $8,304,118 based on the figures of December 31, 1941. Based upon the figures of the Commission and the undeniable statistics of the subsequent operations of the Debtor, the Debtor is now solvent by approximately $16,400,000. The present balance of assets over liabilities may be used, as Debtor has in fact used them, to pay off the principal of existing indebtedness so that future net income will not be subject to the payment of the interest charges thereon. On the other hand, these earnings may be put back into the system in the form of improvements in service, efficiency and equipment so that future revenue will be augmented. These facts become very pertinent in view of the emphasis placed by this court in its decisions upon earning power of debtor roads. The Court of Appeals, however, in its opinion seems to ignore this situation.

As indicated in the petition, Debtor has paid off $10,623,251 of principal and interest which was funded in the plan. The Commission in its supplemental Order (R. 3790) provided that the $75,000,000 capitalization is "subject to variation to the extent, if any, that matured interest proposed to be funded in the plan is paid * * * and as equipment obligations or other liabilities are paid or reduced." This would indicate that the total capitalization of Debtor is to be reduced by such amounts which would leave the capitalization at approximately $64,375,000 without regard to the increase of $11,768,354 in road and equipment property. This would give even greater force to the claims of the stockholders that the plan eliminating them is most inequitable.

In the petition the Debtor pointed out the substantial increase in the account of its property devoted to railway service (p. 12). This showed an increase in road and equipment property from December 31, 1941 (the latest date the Commission could have had in mind in formulating its modified plan) to October 31, 1946 (the last figures available) from $124,808,960 to $136,577,300, an increase of $11,768,354. Certainly these increases in investment in road and equipment are proper additions to the improvement in the financial position of the Debtor for the dates in question.

The petition also pointed out (p. 9) that the Debtor's current financial position (debt, interest and net current assets) has improved by $24,702,942 between December 31, 1941 and October 31, 1946, and is presently improving at the rate of $6,000,000 per year.

The intention of Congress in these matters is demonstrated by the passage at the last session of Congress of the so-called Wheeler-Reed Bill (S. 1253). Under this legislation the then existing reorganiaztion plans for railroads

would have been rejected and the Debtors would have been allowed an eighteen-months period to effect an agreement upon their plans of reorganization with the various interests involved. President Truman vetoed the Bill but indicated in his message that the aim of the legislation, to prevent forfeiture of railroad securities in reorganization proceedings, met with his approval. There seems to be no doubt but that similar legislation will be introduced in the present session of Congress. The case of the Cotton Belt was frequently mentioned throughout the legislative hearings on this Bill as the outstanding case on the issue of the inequity of eliminating junior interests. There was a great deal of public pressure behind this legislation for the reason that it was felt inequitable that stockholder interests should be eliminated in spite of intervening greatly improved financial conditions.

Senator Wheeler, Chairman of the Senate Committee on Interstate Commerce, and one of the sponsors of the legislation, made the following statement:

> "If you had not had these changed conditions there would not have been this complaint we have from all the country, from stockholders and bondholders and everybody else. I just don't believe that the Commission ought to hesitate at all to say that in view of the changed conditions there ought to be some changes."[4]

President Truman wrote in his Memorandum of Disapprovement, dated August 13, 1946:

> "By withholding my signature to this bill I do not intend to indicate that I favor the pending reorganization plans. I am in agreement with those objectives of the bill which prevent undesirable control of the railroads, either immediately or within a few years, and which prevent forfeitures of securities."

[4] Hearings before the Senate Committee on Interstate Commerce on S. 253 (79th Congress, 2nd Session, Page 412).

The Circuit Court of Appeals based its opinion in this case, in part, upon a mistaken interpretation of the records. The court held (R. 5663-5664) that it appeared "that the total long-term debt has increased, as to principal, comparing January 1, 1938 ($70,045,250) with December 31, 1944 ($75,725,439), by the sum of $5,680,189." In so holding the court overlooked a material matter of fact, that is, the figure of $75,725,439 appearing on page 5261 of the printed record includes the Second Mortgage Bonds in the sum of $10,000,000 without deduction of $6,957,500 of these bonds owned by the Debtor (R. 5259), and also includes open accounts with Debtor's wholly-owned subsidiaries, Southwestern Transportation Company and the Southwestern Town Lot Corporation of $890,290 and $11,516, respectively (R. 5261). When these figures are taken into account, the principal of the long-term indebtedness of the Debtor between January 1, 1938 and December 31, 1944, has not increased in the sum of $5,680,189 as stated in the court's opinion but has decreased in the sum of $2,719,116.

Another aspect wherein the opinion of the Circuit Court of Appeals was inadvertently based upon misinterpretation is found (R. 5668) in the following statement:

> "As to reduction in indebtedness, there is question. As to long-term debt, including interest in default and 'other deferred liabilities' (not important comparatively and showing little change) the comparative general balance sheet, for 1941 to 1944, inclusive, shows $85,025,067 for December 31, 1941, $85,344,703 for the same date, 1942, $82,840,465 for 1943 and $85,971,302 for 1944."

The court inadvertently overlooked a change in accounting required by the Interstate Commerce Commission as a result of which the notes of the Chase National Bank of the City of New York, of Mississippi Valley Trust Company, and of the Railroad Credit Corporation are classified

as current liabilities under "loans and bills payable (in default)" for the years 1941, 1942 and 1943, while the same obligations appear for 1944 under "long-term debt." This is shown in Debtor's statements at page 5261 of the printed record.

On Exhibit B attached to the Debtor's petition for rehearing were the details making up the totals in the above quotation to which were added for the years 1941, 1942 and 1943 "loans and bills payable (in default)" giving new totals. On Exhibit B the Second Mortgage Income Bonds were shown at $10,000,000 throughout, and in order to have consistent treatment of the figure of long-term debt, there has been deducted from the total of the long-term debt and overdue interest, $6,957,500 Second Mortgage Income Bonds in the treasury and the open accounts due from the wholly-owned subsidiaries, Southwestern Transportation Company and the Southwestern Town Lot Corporation. Thus the sum of the long-term debt and deferred liabilities for the end of the year 1941 was $82,753,529; for 1942, $82,675,256; for 1943, $80,172,851, and for 1944, $78,111,996. This results in a decrease from the years 1941 to 1944 of $4,641,533 instead of an increase from $85,025,067 in 1941 to $85,971,302 in 1944 as inadvertently stated in the opinion of the court.

One of the reasons assigned for the issuance of the writ in the Petition for Certiorari was that the Circuit Court of Appeals for the Eighth Circuit, in its opinion herein, was in conflict with the Circuit Court of Appeals for the Second Circuit as shown by the decision of said last-named court in the case of **Adelaide H. Knight and William P. Doyle v. Wertheim & Co. et al.** (Decided December 31, 1946: Docket No. 20349). That case involved an appeal from an order of the District Court refusing to submit to the creditors and the shareholders of the Debtor in a

reorganization proceeding under Chapter X of the Bankruptcy Act an "alteration" of a plan of reorganization. The Debtor was the owner of a large office building in New York. The Debtor had one class of capital stock, First Mortgage Bonds in the amount of $16,000,000, Second Mortgage Bonds in the amount of $3000 and 5% Debentures in the amount of $4,754,000. The plan provided that the First Mortgage Bonds should remain untouched, that the balance due on the Second Mortgage Bonds should be paid, that a new company should be formed to issue to the debenture holders convertible income bonds for 60% of their holdings as well as ten shares of new stock for every One Hundred Dollars; that the claims of the unsecured creditors should be paid in full in cash; that the old shareholders should receive shares in the ratio of one to ten. The new convertible income bonds were to be secured by a Second Mortgage and the bondholders had the right to convert them into new shares, within two years after issue, on the basis of sixteen for each one hundred dollars; and within three years after issue on the basis of ten shares for each one hundred dollars.

The petition for reorganization was filed April 10, 1941. The trustee filed the plan of reorganization February 24, 1944. By May 11, 1945 the plan had taken substantially its final form. On December 4, 1945, the court approved the plan. Notice was given to all creditors and shareholders affected and on May 13, 1946, the judge entered an order of confirmation. He signed various auxiliary orders during June and July and on July 8, 1946 entered an order of "consummation." Before the prescribed transfers had been made, two shareholders on July 11, 1946 filed the petition which is the basis of the appeal and which proposed as an "alteration" or "modification" of the plan, an offer of a large real estate company. This offer was to give the old shareholders an option to buy

the new company's shares at $4.50 a share; to underwrite the issue; to receive as a commission 69,686 shares; and with the money so raised, together with the debtor's liquid assets, to pay off the debentures, principal and interest. The option price was later raised to $5.50 and on July 19 to $6.00; the offer was to expire October 17, 1946. The District Court held extensive hearings at which the shareholders urged acceptance and the debenture holders opposed it, for the price of the bonds had risen far above the amount of the principal and interest. The district court denied the petition, using the following language in its memorandum:

> "The deliberate and fully considered adjudication of a responsible court made and entered without objection on the part of any person in interest—and after all parties were afforded ample opportunity to be heard on the merits of the issues involved—and when they and the public—as they had a right to do—confidently relied upon its integrity, should be something more stable than a weathervane. • • • For this reason, my consummation order of July 8, 1946 will stand. It follows that the application to reopen the organization proceedings of the Debtor will be denied."

The appellants argued that the appeal should be dismissed because the bankruptcy judge denied the motions, not for lack of power, but in his discretion and because the offer of the real estate company had expired. The Court of Appeals agreed that the bankruptcy judge had acted in his discretion and said:

> "Therefore, the order may not be disturbed unless he overstepped the permissible limits of his discretion."

The Court of Appeals also disposed of the point that the offer had expired. The court then took up these questions:

First, as to whether the judge had the power to submit the offer to the shareholders; the Court of Appeals held that he did. It traces the steps required by Chapter X, pointing out that the plan shall first have the "approval" of the judge after the hearing provided for by the statute; the parties interested must accept it at a second hearing after which it is ready for "consummation." It must then be performed, "consummated," and when "consummated," the judge must enter a "final decree" which discharges the Debtor from all its debts, cuts off the shareholders, and discharges the trustee. The court points out that the order of "consummation" is not conclusive. A significant quotation from the court's statement upon this point is as follows:

> "The plan, as confirmed, went back at least to December, 1945, and more properly to May, 1945, and the rise in value of the Debtor's property which prompted the offer of the City Investing Company could not have been then foreseen."

The next question considered by the Court of Appeals was whether the judge, having power to accept the "alteration" was free as a matter of discretion to reject it. Here the court said:

> "The only considerations which, so far as we can see, might properly have moved him to do so were (1) a conflict of interest between the debenture holders and the shareholders; (2) the fact that after long years of delay the reorganization had finally culminated in a confirmed plan, and (3) doubts that the new company would be too much stripped of liquid assets to keep afloat. These we shall take up seriatim. We cannot agree that the debenture holders had as yet any legally protected interest in the property beyond the principal and accrued interest of their bonds, which could be weighed against the shareholders' interest. If in fact they had relied upon

sharing in an equity in the property above that amount, it was without warrant of law and constituted no reason for depriving the shareholders of whatever chance might remain of realizing upon their property. * * * It is of course true that there must come a time when a mortgagee or a creditor, who takes over his Debtor's property in extinguishment of the debt, gets an indefeasible title, just as the mortgagee did in equity upon final decree of strict foreclosure; but Chapter X provides its own date when this shall occur; it is the date of the entry of the 'final decree' under Section 228. It is that decree which puts an end to 'all rights and interests of stockholders' and discharges all 'debts and liabilities' of the Debtor. Until then creditors remain creditors; they have their claims and that is all they have; any 'modification' which guarantees them principal and interest on those claims, secures all the rights that a court need regard. The offer of the City Investing Company of July 11, 1946 did that; and we answer the first question that there was no party to the reorganization whose interest the judge could properly weigh against that of the shareholders, except insofar as by further delay the debenture holders' claims might be imperiled.

"Next, as to that delay and as to the fact that the plan had been confirmed." * * *

"That does not indeed mean that delay in presenting an 'alteration' or 'modification' can never be relevant to its approval; we recognize the force of what the judge said in his opinion, which we have quoted, that the considered judgment of a court is not to be lightly put aside. But there can be considerations more imperative than the dispatch of judicial business, even after delays so long as existed in this case. If the legally protected interests of any opposing parties are fully preserved, it is not a good reason to deny others any reasonable chance to protect their own interests that they have been long in asserting them. Had it been shown that the equity which was presupposed in the proposal of the City Investing Company had existed for a substantial time before

> July 11, 1946, there would be force in what the judge said in his opinion; but that was not shown; so far as appears, the equity may have arisen from a recent increase in the value of the property. Delay would not cost the debenture holders anything, for the proposal would give them interest until payment upon the full face of their bonds instead of upon sixty per cent of it; and the property was adequate security."

The Court of Appeals held that the "alteration" should have been submitted and that it was error to deny the petition.

It is obvious that the decision of the Circuit Court of Appeals for the Eighth Circuit in the instant case is at variance with the above quoted opinion of the Circuit Court of Appeals for the Second Circuit. The Second Circuit has clearly stated that the unquestionable equities of the shareholders do not belong to the bondholders and may not be appropriated legally for them. The opinion clearly indicates that while expedition is desirable in the handling of reorganization matters, it is not to be sought at the cost of the legal rights of stockholders who have admitted equities.

As clearly indicated in the foregoing opinion of the Second Circuit, we have not reached the point in the reorganization of the Debtor Railroad where the plan of reorganization has become final and irrevocable. The mere fact that a plan has been approved by the District Court does not create any irrevocable establishment of rights. It is provided in Section 77 (e) [U. S. C. 205 (e)] that after the approval of the plan the judge shall certify his opinion and order to the Commission. The plan is then submitted by the Commission to the creditors and stockholders for acceptance or rejection as provided by law. Next the Interstate Commerce Commission certifies to the judge the results of such submission. Upon receipt of

such certification, the judge confirms the plan if satisfied that it has been accepted as required by law or that it is fair and equitable for the interests of those rejecting it. The District Judge then enters an order and files an opinion of confirmation.

In Section 77 (f) [U. S. C. Section 205 (f)] it is provided that upon confirmation by the judge the provisions of the plan shall (subject to the right of judicial review) be binding upon the debtor and all stockholders thereof and all creditors. Upon termination of the proceedings a final decree is entered discharging the trustee or trustees and making such provisions as may be equitable by way of injunction or otherwise and closing the case.

It is clear, therefore, that the security holders of the Debtor for whom provision has been made in the present plan of reorganization have no vested or irrevocable rights therein which may not be altered by any new plan necessary to do full justice to the stockholders of the Debtor as well as to other security holders.

II.

The Circuit Court of Appeals Erred in Holding the Reorganization Plan of the Interstate Commerce Commission to Be Equitable, Even Though It Excluded the Debtor's Stockholders From Participation Therein, When the Plan Was Formulated on the Theory That the Debtor's Post-War Peacetime Earnings Would Not Exceed Debtor's Pre-War Peacetime Earnings, Even Though at the Time of the Decision by the Court of Appeals These Earnings Were Proven to Be Much Greater.

The Circuit Court of Appeals in its opinion tended to ignore all questions except the question of earnings in passing upon the plan promulgated by the Commission.

In ignoring all factors other than earnings, it is respectfully submitted the Court of Appeals was in error.

As we have already pointed out, Subsection (b) of Section 77 directs the providing of fixed charges in such an amount that "after due consideration of the probable prospective earnings of the property in light of its earnings experience and all other relevant facts, there shall be adequate coverage of such fixed charges by the probable earnings available for the payment thereof." We have heretofore called attention to the fact that the earnings to be considered are not the "absolutely certain" earnings but the "probable prospective" earnings of the property. In determining these earnings, the Commission is enjoined to consider the "earnings experience" and "all other relevant facts." These relevant facts certainly include (1) the solvency of the Debtor Road, (2) the increase in rates allowed by the Interstate Commerce Commission, (3) the improvement in the system of the Debtor and (4) the greatly increased population and industry of the area served by the Debtor.

By Subsection (e) of Section 77, in determining value due consideration must be given to the earning power of the property, past, present, and prospective and all other relevant facts.

One element of future earning power of the Debtor which could not have been considered by the Court of Appeals and yet which has important bearing upon the problem, is the action of the Interstate Commerce Commission in its decision of December 5, 1946. In Ex Parte No. 162, Increased Railway Rates, Fares and Charges, 1946, and Ex Parte No. 148, Increased Railway Rates, Fares and Charges, 1942, the Commission permits increases of basic freight rates by twenty per cent for the future and permits continuation of previously granted passenger fare

increases. Certainly it cannot be denied that this greatly enhances the Debtor's permanent post-war earning power considerably beyond anything the Interstate Commerce Commission could have had in mind when it formulated its plan and beyond what the Circuit Court of Appeals could have had in mind when it looked out upon so pessimistic and dark a future.

This authorized rate increase shows that this Court's pessimism was unjustified in the **Ecker** case, supra, when it said, l. c. 508, 950: "Already serious proposals for decrease of tariffs have been advanced."

In its petition Debtor pointed out the marked and spectacular population growth in the area served by the Debtor Railroad and its connections. It is entirely possible that the war contributed to this increase but there is no indication whatsoever that the population shift has not become permanent. The population of Los Angeles increased in six years by twenty per cent from April, 1940 to January, 1946. Houston increased from 384,514 to 478,000, Dallas from 294,734 to 425,000 and Ft. Worth from 177,662 to 235,117. These increases occurred in the six years between 1940 and 1946. The total California and Texas population increases between April of 1940 and July of 1945 were 27.7 per cent and 5.8 per cent, respectively. During this same period the total population of the United States as a whole increased by only .2 per cent.

The business growth of these cities has been equally phenomenal.[5]

Even if we were entirely to ignore the other vitally important circumstances, nevertheless, on the basis of estab-

[5] The Monthly Business Review of the Federal Reserve Bank of Dallas, January 1, 1946, Volume 31, No. 1, pages 3-4, makes the following observation in an article captioned "Postwar Prosperity in the Southwest": "This regional area experienced a greatly accelerated industrial expansion and development during the war years, the rate of growth having been above the average rate of expansion for the country as a whole."

lished earnings alone the inequity of the proposed plan of reorganization is apparent. Appendix C to the petition shows the income available for fixed charges during the first ten months of operation during the year 1946 to be $5,949,631.47. Projecting this figure for the balance of the year, the annual income available for fixed charges will be approximately $7,000,000. This is greatly in excess of the pre-war peacetime earnings during any year considered by the Interstate Commerce Commission. It is from two to six times as large as the comparable figures for the pre-war period from 1930 to 1940. The Commission's plan (R. 3785) provides annual charges of $2,451,228 consisting of $1,513,723 interest and $937,505 for preferred stock dividends. The 1946 income available for fixed charges is, therefore, nearly three times the amount of these annual charges. Bearing in mind that the year 1946 represents peacetime earnings, this figure is highly significant.

The figure may also be considered an indication of Debtor's long-term future in view of the intervening industrial development and population growth as well as because of the action of the Interstate Commerce Commission above referred to in awarding the substantial rate increases. Certainly these earnings for the year 1946 cannot be cataloged in the Circuit Court's brusque fashion as "uncertain elements" or as elements which "can find no place in estimated future earnings for reorganization valuation purposes."

With these high peacetime earnings we have an element in the instant case which clearly and unequivocably distinguishes it from the **Milwaukee**, the **Western Pacific** or the **Denver & Rio Grande** cases heretofore considered by this court.

Moreover, upon reconsideration of its plan, lower interest rates could be justifiably provided for by the Com-

mission so that the same amount of net earnings hereafter could take care of the annual costs of a considerably higher capitalization than was the case when the Commission considered this capitalization.

III.

The Circuit Court of Appeals Erred in Ignoring the Provisions of Amendment V to the Constitution of the United States Which Provide That No Person Shall Be Deprived of Property Without Due Process of Law and That Private Property Shall Not Be Taken for Public Use Without Just Compensation, by Sustaining a Plan of Reorganization Which Completely Excludes Stockholders From Participation Therein at a Time When the Unquestioned Records of Debtor Show That Such Stockholders Have a Very Definite Equity in the Corporation.

The Bankruptcy Act itself and the adjudicated cases demonstrate clearly that the bankruptcy power is subject to the due process clause of Amendment V to the Federal Constitution. Section 77 (e) of the Bankruptcy Act [11 U. S. C. 205 (e)] expressly provides that the court shall give "due notice" to all parties in interest of the time within which such parties may file their objections to the plan. It provides that the judge shall "after notice" in such manner as he may determine to the Debtor, its trustee, stockholders, creditors, and the Commission "hear" all parties in interest. It provides that after such hearing, if objections are filed to the plan, the judge shall approve the plan if satisfied that it is "fair and equitable," does not "discriminate" unfairly in favor of any class of creditors or stockholders, and will conform to the requirements of the "law of the land." It provides that in determining value such effect shall be given to the present cost of reproduction new and less depreciation and the original

cost of the property, and the actual investment therein "as may be required under the law of the land," in light of its earning power and other relevant facts. All of these various terms, namely, "notice", "hearing", "fairness", "equity", "no unfair discrimination" and "law of the land" connote that "due process of law" as those words are employed in the Federal Constitution, is contemplated and required in the court's approval of a plan of reorganization.

The case of **Pennoyer v. Neff**, 95 U. S. 714, 24 L. Ed. 565, is a milestone on the subject of due process of law. Pertinent language appearing in this opinion, l. c. 732, 572, is as follows:

> "Whatever difficulty may be experienced in giving to those terms ["due process of law"] a definition which will embrace every permissible exertion of power affecting private rights, and exclude such as is forbidden, there can be no doubt of their meaning when applied to judicial proceedings. They then mean a course of legal proceedings according to those rules and principles which have been established in our systems of jurisprudence for the protection and enforcement of private rights."

To take existing valuable rights from the stockholders of the Debtor under the proposed plan of reorganization is clearly violative of the provisions of the Fifth Amendment to the United States Constitution.

This court recognized the point here made by Debtor in the case of **Louisville Joint Stock Land Bank v. Radford**, 295 U. S. 555, 79 L. Ed. 1593. Mr. Justice Brandeis there declared, l. c. 589, 1604:

> "The bankruptcy power, like the other great substantive powers of Congress, is subject to the Fifth Amendment. Under the bankruptcy power Congress may discharge the Debtor's personal obligations because, unlike the states, it is not prohibited from im-

pairing the obligation of contracts. * * * But the effect of the act here complained of is not the discharge of Radford's personal obligation. It is the taking of substantive rights in specific property acquired by the Bank prior to the Act."

And subsequently in the same case it was stated, l. c. 602, 1611:

"For the Fifth Amendment commands that, however great the Nation's need, private property shall not be thus taken even for a wholly public use without just compensation. If the public interest requires, and permits, the taking of property of individual mortgagees in order to relieve the necessities of individual mortgagors, resort must be had to proceedings by eminent domain; so that, through taxation, the burden of the relief afforded in the public interest may be borne by the public."

The last quoted section is particularly applicable to the facts of the instant case. No public emergency, however great, could constitutionally sanction the taking from the stockholders of the Debtor their established existing values without compliance with constitutional limitations.

The Bankruptcy Act, as amended, defines solvency in the following language [11 U. S. C. A., Sec. 1 (19)]:

"A person shall be deemed insolvent within the provisions of this title whenever the aggregate of his property, exclusive of any property which he may have conveyed, transferred, concealed, removed, or permitted to be concealed or removed, with intent to defraud, hinder, or delay his creditors, shall not at a fair valuation be sufficient in amount to pay his debts."

By these standards the Debtor corporation is unquestionably solvent at the present time by a clear margin.

An illuminating decision is that of the Circuit Court of Appeals for the Second Circuit in the case of **Meyer**

et al. v. Dolan et al., 145 Fed. (2d) 880 (Certiorari Denied, 65 S. Ct. 916, 89 L. Ed. 1422). This was an appeal from an order of the District Court for the Northern District of New York made after hearings on a plan of reorganization proposed by the trustee of a debtor in proceedings under Chapter X of the Bankruptcy Act. The court found that the debtor was insolvent and the order from which the appeal was taken was to the effect that its common stockholders had no interest to be protected in the reorganization proceedings. The court said, l. c. 881:

> "This is one of several plans for reorganization which have been proposed and which have failed of adoption for one reason or another, and the present issue is a rather narrow one. **Whether or not the debtor is insolvent and its common stock is, therefore, to be treated as worthless in proposing and considering a plan of reorganization depends, of course, upon whether the amount of its liabilities exceeds the fair market value of its assets.** 11 U. S. C. A. 1 (19). That is a question of fact which the judge below decided adversely to the appellant * * *." (Emphasis supplied.)

We are not here dealing with the right of Congress by appropriate legislation to impair the obligation of contracts. We are dealing with the question of the right, under Congressional enactments, to destroy a property interest.

This distinction is made in the case of **Kuehner v. Irving Trust Company**, 299 U. S. 455, 81 L. Ed. 340. This case dealt with the restriction in Section 77B (b) (10) of the Bankruptcy Act upon the claim of the landlord under a lease. The point was made that it actually offended the due process guarantee by destruction of rights conferred by the lease. Reference was made to the **Louisville Joint Stock Land Bank v. Radford** case, supra. This court said, l. c. 451-2, 345:

> "As pointed out in the case last cited there is, as respects the exertion of the bankruptcy power, a significant difference between a property interest and a contract, since the constitution does not forbid impairment of the obligation of the latter. The equitable distribution of the bankrupt's assets or the equitable adjustment of creditors' claims in respect of those assets, by way of reorganization, may therefore be regulated by a bankruptcy law which impairs the obligation of the debtor's contracts."

This court has always recognized the applicability of the provisions of the Fifth Amendment to railroad reorganizations. In the **Denver & Rio Grande Western Railroad Company Case**, supra, this court said, l. c. 1140-41:

> "(After speaking of the purposes of Congress in enacting Section 77) * * * the answer reached by Congress was that the experience and judgment of the Commission must be relied upon for final determinations of value and of matters affecting the public interest, subject to judicial review **to assure compliance with constitutional and statutory requirements.**" (Emphasis supplied.)

If, in fact, the Debtor at the time of the final order of reorganization is not insolvent the court would not be justified in approving any plan which excludes stockholders. The "due process" clause of the Fifth Amendment of the Federal Constitution protects the rights of all parties having an interest in the Debtor's property. No distinction can be made between stockholders and creditors in according "due process of law" in a reorganization proceeding.

It is therefore apparent that the proposed plan of the Commission under the existing circumstances violates the constitutional provisions contained in Amendment V.

CONCLUSION.

Wherefore, it is respectfully submitted that a writ of certiorari should issue as prayed.

Dated January 17, 1947.

JACOB M. LASHLY,
705 Olive Street,
St. Louis 1, Missouri,
Attorney for St. Louis Southwestern
Railway Company, a corporation,
Debtor, Petitioner.

(Appendices Follow.)

APPENDIX A.

APPENDIX A.

ST. LOUIS SOUTHWESTERN RAILWAY LINES

Long Term Debt; Interest in Default; and Net Current Assets as of Various Dates.

	December 31, 1941	December 31, 1943	December 31, 1944	December 31, 1945	July 31, 1946	October 31, 1946
Record reference	5259) 5261)	5259) 5261)	5259) 5261)	5694) 5696)	5694) 5696)	(Note)
Long Term Debt:						
First Mortgage Bonds	$20,950,000	$20,950,000	$20,950,000	$20,950,000	$20,950,000	$20,950,000
Equipment Trust Obligations	216,000	108,000	54,000	.....	.....	.....
Second Mortgage Bonds	3,042,500*	3,042,500*	3,042,500*	3,042,500*	3,042,500*	3,042,500*
First Terminal & Unifying Mortgage Bonds	8,063,000	8,063,000	8,063,000	8,063,000	8,063,000	8,063,000
General & Refunding Mortgage Bonds	9,327,500	9,327,500	9,327,500	9,327,500	9,327,500	9,327,500
Railroad Credit Corporation Note	#	#	557,989	421,940	382,249	.....
Chase National Bank Note	#	#	3,500,000	3,500,000	3,500,000	3,500,000
Mississippi Valley Trust Company Note	#	#	1,000,000	1,000,000	1,000,000	1,000,000
Reconstruction Finance Corporation Note (bought by Southern Pacific)	17,882,250	17,882,250	17,882,250	17,882,250	17,882,250	17,882,250
Texarkana Union Station Trust	315,000	315,000	315,000	315,000	315,000	315,000
First Mortgage Bonds in default	3,250,680	3,173,895	3,173,895	3,173,895	3,173,895	3,173,895
Loans & Bills Payable in default	5,658,469#	5,313,289#	.....#	.....#	.....#	.....#
Total Long Term Debt	$68,705,399	$68,175,434	$67,866,134	$67,676,085	$67,636,394	$67,254,145

Note: Figures for October 31, 1946 are taken from Appendix B to this petition.

* $10,000,000 outstanding, less $6,957,500 held in treasury.

\# Notes of the Railroad Credit Corp., Chase National Bank and Mississippi Valley Trust Co. were classified as "Loans and Bills Payable in Default" (a part of current liabilities) until January 1, 1944 when these debts were classified under "Long Term Debt" in accordance with Interstate Commerce Commission rules.

Interest in Default:						
Second Mortgage Bonds	$ 547,650	$ 60,850	$ 60,850	$	$	$ .....
First Terminal & Unifying Mortgage Bonds	2,418,900	1,411,025	403,150	201,575	33,596	134,383
General & Refunding Mortgage Bonds	3,031,437	3,124,713	3,031,438	2,575,063	1,904,365	2,020,958
Central Arkansas & Eastern Bonds	265,203	265,203	265,203	265,203	265,203	265,203
Stephenville North & South Texas Bonds	665,697	665,697	601,611	601,611	601,611	601,611
Reconstruction Finance Corporation	5,573,776	5,172,810	4,613,783	3,098,635	1,218,175	1,443,541
Others	1,360,160	1,236,485	1,080,458	670,764	167,971	225,130
Total Interest in Default	$13,862,823	$11,936,783	$10,056,493	$ 7,412,851	$ 4,190,921	$ 4,690,826
Total Current Assets	$10,883,688	$39,169,687	$43,566,776	$41,775,464	$34,285,775	$32,545,847
Total Current Liabilities less Loans & Bills Payable in default	2,872,875	25,729,597	29,389,479	20,535,069	13,809,181	10,455,343
Net Current Assets	$ 8,010,813	$13,440,090	$14,177,297	$21,240,395	$20,476,594	$22,090,504

APPENDIX B.

ST. LOUIS SOUTHWESTERN RAILWAY LINES
Berryman Henwood, Trustee
GENERAL BALANCE SHEET OCTOBER 31, 1946
ELIMINATING INTER-COMPANY ITEMS

ASSETS

Investments	Oct. 31, 1946
Road and equipment property	$136,538,870.45
Improvements on leased property	38,443.24
Less:	
Donations and grants	317,830.86
Accrued depreciation—Road	591,070.73
Accrued depreciation—Equipment	11,892,479.48
Accd. amort. of defense projects—Rd.	1,356,404.75
Accd. amort. of defense projects—Eq.	4,322,914.16
Net investment in Road & Equip.	118,096,613.71
Capital and other reserve funds	160,186.65
Miscellaneous physical property	275,368.28
Investments in affiliated companies:	
(A) Stocks	2,447,507.00
(B) Bonds	816,004.00
(C) Other secured obligations	7,376.27
(E) Investment advances	1,213,812.56
Other investments:	
(A) Stocks	54.48
(B) Bonds—Second Mortgage Income Bonds	6,957,500.00
(E) Advances	8,112.69
Total investments	129,982,535.64

Current Assets

Cash	1,281,303.54
Temporary cash investments	21,708,620.00
Special deposits	1,385,961.75
Traffic and car-service balance—Dr.	1,944,736.64
Net bal. receivable from agts. & conds.	468,468.81
Miscellaneous accounts receivable	1,499,962.53
Material and supplies	4,110,997.63
Interest and dividends receivable	16,800.00
Accrued accounts receivable	104,913.48
Other current assets	24,083.08
Total current assets	32,545,847.46

Deferred Assets

Working fund advances	39,476.49
Insurance and other funds	76 500.00
Other deferred assets	28,393.69
Total deferred assets	144,370.18

Unadjusted Debits

Prepayments	22,536.99
Other unadjusted debits	741,071.67
Total unadjusted debits	763,608.66
Grand Total	163,436,361.94

ST. LOUIS SOUTHWESTERN RAILWAY LINES
Berryman Henwood, Trustee
GENERAL BALANCE SHEET OCTOBER 31, 1946
ELIMINATING INTER-COMPANY ITEMS

LIABILITIES	Oct. 31, 1946
Capital stock—Common	$ 17,186,100.00
Preferred	19,893,600.00
Total stock	37,079,700.00
Long Term Debt	
Funded debt unmatured:	
First Mortgage Bonds	20,950,000.00
Second Mortgage Income Bonds	10,000,000.00
Texarkana Union Sta. Tr. Ctfs. Ser. "A"	315,000.00
Debt in default:	
First Mortgage Bonds	3,173,894.68
First Terminal & Unify. Mtg. Bonds	8,063,000.00
Gen. & Ref. Mtg. 5% Gold Bds. Series "A"	9,327,500.00
The Chase Natl. Bk. of the City of N. Y.	3,500,000.00
Mississippi Valley Trust Co.	1,000,000.00
Amounts payable to affiliated companies:	
Notes—RFC—Purchased by Sou. Pac. Co.	17,882,250.00
Open Accounts—Southwestern Transp. Co.	890,289.51
The S. W. Town Lot Corp.	20,444.97
Total long term debt	75,122,379.16
Current Liabilities	
Audited accounts and wages payable	1,814,177.14
Miscellaneous accounts payable	258,322.37
Interest matured unpaid	1,173,203.15
Unmatured interest accrued	63,170.82
Accrued accounts payable	58,711.50
Taxes accrued:	
State, county and city taxes	689,423.17
Federal income tax	6,021,755.77
Other federal taxes	126,348.24
Other current liabilities	249,730.76
Total current liabilities	10,455,342.92
Deferred Liabilities	
Interest in default:	
First Term. & Unify. Mtg. Bonds	134,383.33
Gen. & Ref. Mtg. 5% Gold Bds. Series "A"	2,020,958.33
Cent. Ark. and East. RR. Co. 1st Mtg. Bds.	265,202.93
S. N. & S. T. Ry. Co. First Mtg. Bonds	601,611.48
Reconstruction Finance Corporation	1,443,540.80
Others	225,130.41
Other deferred liabilities	199,620.04
Total deferred liabilities	4,890,447.32
Unadjusted Credits	
Other unadjusted credits	390,514.21
Accrued depreciation—Leased property	143,448.54
Total unadjusted credits	533,962.75
Surplus	
Earned surplus—Unappropriated	35,354,529.79
Total surplus	35,354,529.79
Grand Total	163,436,361.94

APPENDIX C.

ST. LOUIS SOUTHWESTERN RAILWAY LINES
Berryman Henwood, Trustee

INCOME ACCOUNT TEN MONTHS 1946

	January 1 to October 31, 1946
Railway Operating Revenues:	
Freight	$35,173,316.20
Passenger	1,571,517.14
Mail	259,914.08
Express	289,782.53
Miscellaneous transportation	240,709.29
Incidental	571,857.06
Joint facility (Net)	19,790.51
Total	38,126,886.81
Railway Operating Expenses:	
Maint. of Way & Structures	6,389,177.24
Maint. of Equipment	5,689,629.81
Traffic	1,196,526.14
Transportation	12,393,453.03
Miscellaneous Operations	372,011.68
General	1,127,437.17
Total	27,168,235.07
Net rev. from ry. oper's	10,958,651.74
Railway Tax Accruals:	
State, County & City taxes	831,222.58
Federal income tax	2,150,193.15
Fed. inc. tax—adj. 1941 & 1945	Cr. 403,095.39
Other federal taxes	1,196,315.93
Total	3,774,636.27
Railway operating income	7,184,015.47
Rent Income:	
Rent from locomotives	1,740.45
Rent from pass. train cars	25,001.26
Rent from work equipment	643.54
Joint facility rent income	281,135.79
Total	308,521.04
Rents Payable:	
Hire of frt. cars—Dr. bal.	995,685.83
Rent for locomotives	29.94
Rent for pass. train cars	84,012.86
Rent for work equipment	274.75
Joint facility rents	755,267.72
Total	1,835,271.10
Net rents—Debit	1,526,750.06
Net railway optg. income	5,657,265.41

Continued on next page

ST. LOUIS SOUTHWESTERN RAILWAY LINES
Berryman Henwood, Trustee

INCOME ACCOUNT TEN MONTHS 1946

	January 1 to October 31, 1946
Brought forward	$ 5,657,265.41
Other Income:	
Income from lease of rd. & equip.	8,362.60
Miscellaneous rent income	36,587.93
Miscl. nonoptg. phys. property	11,281.85
Income from funded securities	35,553.60
Income from unfd. sec. & accts.	218,617.93
Miscellaneous income	1,009.58
Total	311,413.49
Total income	5,968,678.90
Miscellaneous Deductions from Income:	
Miscellaneous rents	316.41
Miscellaneous tax accruals	656.26
Maint. of invest. organization	201.10
Miscl. income charges	17,873.66
Total	19,047.43
Inc. avail. for fixed chgs.	5,949,631.47
Fixed Charges:	
Rent for leased roads & equip.	11,248.18
Interest on funded debt (fixed)	2,483,068.37
Interest on unfunded debt	9,229.80
Total	2,503,546.35
Net income	3,446,085.12
Disposition of Net Income:	
Bal. of inc. transferred to Earned Surplus	3,446,085.12

APPENDIX D.

UNITED STATES CIRCUIT COURT OF APPEALS
For the Second Circuit.

No. 82—October Term, 1946.

(Argued November 11, 1946 Decided December 31, 1946.)

Docket No. 20349.

ADELAIDE H. KNIGHT, AND WILLIAM P. DOYLE,
Appellants,

v.

WERTHEIM & CO., ET AL.,
Appellees.

Before:

L. Hand, Augustus N. Hand Chase,
Circuit Judges.

Appeal from an order of the District Court for the Southern District of New York, denying a motion to amend a plan of corporate reorganization after confirmation under Chapter X of the Bankruptcy Act. Also two appeals from two other orders, ancillary to the first.

T. Roland Berner, for Knight and Doyle, appellants.

John Gerdes, for Wertheim & Co., et al., appellees.

Louis G. Bernstein, for a committee of other debenture holders, appellees.

Henry S. Hooker, for Duncan, Trustee, appellee.

George T. Barker, for Hudson Maguire, et al., appellees.

George Zolotar, for the Securities and Exchange Commission.

L. Hand, Circuit Judge:

This appeal and two other appeals are from an order and two ancillary orders of the Bankruptcy Court, refusing to submit an "alteration" of a plan of reorganization to the creditors and shareholders of the debtor. The debtor is the owner of a large office building in lower Manhattan, known as the Equitable Office Building, which on April 10, 1941, filed a petition for reorganization under Chapter X. It had but one class of capital stock, which was without par value and consisted of 862,098 shares; it had issued bonds of $16,000,000, secured by a first mortgage; second mortgage bonds, of which only $3000 remained outstanding; and $4,754,000 outstanding of five per cent debentures, due May 1, 1952. The court approved the petition on the day it was filed; but it was not until nearly three years later—on February 24, 1944—that the trustee filed any plan of reorganization under §169. Various amendments were proposed to this from time to time thereafter; but the plan had taken substantially its present form by May 11, 1945.

It provided that the first mortgage of $16,000,000 should remain untouched; that the $3000 remaining due

on the second mortgage should be paid; that a new company should be formed which should issue to the debenture holders convertible income bonds for sixty per cent of their holdings, as well as ten shares of new stock for every $100; that the claims of the unsecured creditors should be paid in full in cash; and that the old shareholders should receive new shares in the ratio of one to ten. The new convertible income bonds were to bear cumulative interest at five per cent, were to mature in thirty-five years and were to be secured by a second mortgage; the bondholders had the right to convert them into new shares, within two years after issue, on the basis of sixteen for each $100; and, within three years after issue, on the basis of ten shares for each $100. The authorized capital of the new company was to be 1,017,933.8 shares, of a par value to be ascertained by the trustee and approved by the court: 475,400 of which would be issued at once to the debenture holders, 456,384 would be reserved against the conversion privilege of the new bonds; and 86,209.8 shares would go to the old shareholders. Administrative and reorganization expenses were to be paid out of the cash in the hands of the trustees. On October 31, 1945, the current liabilities of the debtor were $242,000, together with $950,000 back interest upon the debentures.

Other amendments were proposed by creditors and shareholders after May 11, 1945, but on December 4, 1945, the court approved the plan under § 174 as it had finally taken shape. Notice was then given under § 175 "to all creditors and shareholders who are affected," and the plan came on for confirmation under § 221 on May 13, 1946, when the judge entered an order of confirmation. He signed various auxiliary orders during June and July, which are not important; and on July 8, 1946, entered an order of "consummation." This was not the "final decree" required by § 228, which presupposes earlier "con-

summation"—performance—of the plan; it merely provided in detail the steps necessary to "consummate" the plan. Before the prescribed transfers had been made, two shareholders, Knight and Doyle, on July 11, 1946, filed the petition which is the basis of this appeal, and which proposed, as an "alteration" or "modification" of the plan, an offer, made to the judge and the trustee in a letter of the City Investing Company (a large real estate company). This offer was to give the old shareholders an option to buy the new company's shares at $4.50 a share; to underwrite the issue; to receive as a commission 69,686 shares; and with the money so raised, together with the debtor's liquid assets, to pay off the debentures, principal and interest. The option price was later raised to $5.50, and finally (on July 19th) to $6; the offer was to expire on October 17, 1946.* The judge held extensive hearings at which attorneys representing a substantial number of shareholders appeared and urged the acceptance of the offer; and at which the debenture holders unanimously opposed it, as was readily understandable, since the price of the bonds had risen far above the amount of principal and interest. The court denied the petition in a short memorandum, as follows:

> "The deliberate and fully considered adjudication of a responsible court made and entered without objection on the part of any person in interest—and after all parties were afforded ample opportunity to be heard on the merits of the issues involved—and when they and the public—as they had a right to do—confidently relied upon its integrity, should be something more stable than a weather vane. * * * For

* On November 1, 1946, it would have taken $5,942,500 to pay the debentures with interest; the sale of 862,098 shares at $6 would result in $5,172,588; the deficit of $769,912 would be paid by the cash balance, estimated on November first at $942,500, leaving a cash balance of only about $170,000 as of that date. The estimated income for each month was $315,000, and the estimated operating expenses for the five months of November to March, inclusive, were $104,000 a month.

this reason, my consummation order of July 8, 1946, will stand. It follows that the application to reopen the reorganization proceedings of the debtor will be denied."

It was from this order and two other orders, which it is not necessary here to consider, that Knight and Doyle have appealed.

The appellees argue that the appeal should be dismissed for two reasons: (1) because the bankruptcy judge denied the motions, not for lack of power, but in his discretion; (2) because the offer of the City Investing Company has now long since expired, and the whole controversy has become moot. We agree that the judge did not decide from lack of power, and that he exercised his discretion; indeed, we should have had to assume as much anyway, had not his opinion, just quoted, proved it. Therefore, the order may not be disturbed unless he overstepped the permissible limits of his discretion. We also overrule the other ground for dismissing the appeal: i. e., that it has become moot. It is indeed true that the offer of the City Investing Company has long since lapsed, and that at present there is no outstanding offer; but it does not follow that a new offer may not be made of enough cash to pay off the debentures. That depends upon whether the City Investing Company, or some other company, will make such an offer; we cannot say on this record that the value of the debtor's property has so fallen in the past six months that the equity has for practical purposes disappeared; and indeed the strong resistance of the debenture holders to the appeal suggests that it has not.

The first question on the merits is whether the judge had the power, as he supposed, to submit the offer to the shareholders, because, if, as the appellees insist, he had not, it makes no difference whether he did not keep within

the bounds of a sound discretion. We agree that he did have the power. Chapter X requires that a plan shall first have the "approval" of the judge (§ 174) after the hearing provided in § 169 and § 170. The parties interested must then accept it at a second hearing as provided in § 174, after which it is ready for "confirmation" under § 221. It must then be performed, "consummated" (§§ 224-227), and when "consummated," the judge must enter a "final decree" (§ 228), which discharges the debtor from all its debts, cuts off the shareholders, and discharges the trustee. The Act makes no provisions for any "order of consummation" such as the judge entered on July 8, 1946; and, although it is a convenient way of specifying exactly how the plan is to be performed, as we have already said, it is not to be confused with the "final decree." The order of "confirmation" is not conclusive, for § 222 expressly provides that the plan may be "altered or modified" after, as well as before, the plan has been confirmed. If an "alteration" or a "modification" does not "materially and adversely affect the interests of creditors or stockholders," this may be done without further hearing; otherwise, if it does. It must be observed that, so far as concerns merely the grant of power, the statute makes no difference between the periods before and after confirmation. That does not indeed mean that the fact of confirmation should play no part in the decision whether to use the power; but it does mean that confirmation is only a circumstance in the whole nexus of facts which will determine the question. Against this the debenture holders invoke our decision in **Country Life Apartments v. Buckley,*** and the decision of the Seventh Circuit in **Diversey Building Corp. v. Metropolitan Trust Co.**** In the first, the plan had provided for an outright sale of the property for cash at auction, and the "modification" required the creation of a new

* 145 Fed. (2) 935.

** 141 Fed. (2) 65.

corporation, the shares in which were to be exchanged for claims against the debtor; in the second, the plan had been in operation for nearly eight years after confirmation; under it an old bond issue had been divided into two parts of different priorities; and the "modification" proposed an exchange of one of these new issues for preferred and common shares, and the outright cancellation of the other. We said in our opinion that there was a limit to what might be considered an "alteration" or a "modification" and that the proposal had exceeded it; and the Seventh Circuit spoke of the court's not having "jurisdiction" to act upon the proposal; we agree that, although there appear to be no limits to the changes which may be made in a plan before "approval," and indeed thereafter, until "its submission for acceptance" under § 179, nevertheless any changes after submission must be to some extent congruent with the plan. We cannot, however, agree that there are narrower or more definite limits than this. There is nothing whatever in the joint report of the House and Senate Committee on § 77 B to support such a conclusion. It is true that one clause of that report explained subdivision (f)—the precursor of § 222—as directed to the correction of "errors, mistakes and omissions"; indeed, Congress may have had such modifications in mind as those which would not "adversely affect the interests of creditors or shareholders." But the same clause begins with the words "matters not foreseen," and the proposed "modification" at bar was of that kind: it provided for "matters not foreseen." The plan as confirmed went back at least to December, 1945, and more properly to May, 1945, and the rise in value of the Debtor's property which prompted the offer of the City Investing Company could not have been then foreseen. Nor were the proposed changes themselves so radical as to fall within our decision in **Country Life Apartments v. Buckley**, supra.* The first mortgage was

* 145 Fed. (2) 935.

to remain as before; the balance upon the second mortgage was to be paid as before; a new corporation was to be organized with the same capital as before; the old shareholders were to have the same number of new shares as before; the current liabilities were to be paid as before. The only change was that the debenture bonds were to be paid in cash instead of refunded in new bonds and new shares, and that to do this the shares which had been reserved for them, either immediately, or to answer their conversion privilege, were to be sold to the old shareholders, taken up by the City Investing Company, or were to go to that company for its underwriting commission.

There remains the question whether the judge, having power to accept the "alteration," was free as matter of discretion to reject it. The only considerations which, so far as we can see, might properly have moved him to do so were (1) a conflict of interest between the debenture holders and the shareholders; (2) the fact that after long years of delay the reorganization had finally culminated in a confirmed plan, and (3) doubts that the new company would be too much stripped of liquid assets to keep afloat. These we shall take up seriatim. We cannot agree that the debenture holders had as yet any legally protected interest in the property beyond the principal and accrued interest of their bonds, which could be weighed against the shareholders' interest. If in fact they had relied upon sharing in an equity in the property above that amount, it was without warrant of law and constituted no reason for depriving the shareholders of whatever chance might remain of realizing upon their property. The debenture holders were in truth not "adversely affected" by the proposed "alteration," within the meaning of § 222. It is, of course, true that there must come a time when a mortgagee or a creditor, who takes over his debtor's property in extinguishment of the debt, gets an indefeasible title, just as the

mortgagee did in equity upon final decree of strict foreclosure; but Chapter X provides its own date when this shall occur; it is the date of the entry of the "final decree" under § 228. It is that decree which puts an end to "all rights and interests of stockholders" and discharges all "debts and liabilities" of the debtor. Until then creditors remain creditors; they have their claims and that is all they have; any "modification" which guarantees them principal and interest on those claims, secures all the rights that a court need regard. The offer of the City Investing Company of July 11, 1946, did that; and we answer the first question that there was no party to the reorganization whose interest the judge could properly weigh against that of the shareholders, except in so far as by further delay the debenture holders' claims might be imperiled.

Next as to that delay and as to the fact that the plan had been confirmed. We recognize that, except upon the extremest provocation, courts will not upset a judicial sale at auction, upon the ground that a new bidder has appeared who offers more than the knock-down price. **Morrison v. Burnette,*** **In re Burr Manufacturing and Supply Co.,**** **Currin v. Nourse.***** This unwillingness results from the effect upon such sales of knowing that a prospective bidder may abstain from bidding at the auction, may bide his time, and may then outbid the price at which the property has been struck down. That possibility tends to chill bidding at the sale, to dispose of the property by later competition on successive bids, and thus to defeat the very purpose of an auction, which is to fetch together all those who may be interested to buy and to set them against each other with whatever stimulus that may provide, as opposed to other kinds of sale. None of this applies to a plan of reorganiza-

* 154 Fed. Rep. 617, 624 (C. C. A. 8).

** 217 Fed. Rep. 16 (C. C. A. 2).

*** 66 Fed. (2) 137, 140 (C. C. A. 8).

tion. True, that presupposes a concourse of conflicting interests—creditors of different priorities and shareholders of different ranks—whose compromise in the plan itself will be a result of competition. But there is no occasion when all are brought together and pitted against each other in a cash bidding, i. e., there is no occasion equivalent to an auction whose finality must be preserved if its advantages are to be preserved.

That does not indeed mean that delay in presenting an "alteration" or "modification" can never be relevant to its approval; we recognize the force of what the judge said in his opinion, which we have quoted, that the considered judgment of a court is not to be lightly put aside. But there can be considerations more imperative than the despatch of judicial business, even after delays so long as existed in this case. If the legally protected interests of any opposing parties are fully preserved, it is not a good reason to deny others any reasonable chance to protect their own interests that they have been long in asserting them. Had it been shown that the equity which was presupposed in the proposal of the City Investing Company had existed for a substantial time before July 11, 1946, there would be force in what the judge said in his opinion; but that was not shown; so far as appears, the equity may have arisen from a recent increase in the value of the property. Delay would not cost the debenture holders anything, for the proposal would give them interest until payment upon the full face of their bonds instead of upon sixty per cent of it; and the property was adequate security.

The last question remains, whether the new company would have been so stripped of quick assets that it might prove unable to carry on its business, i. e., that its cash resources would have been at the danger point. This must be judged on the assumption that the debenture bonds

would be paid off, and that the new company would owe nothing but its first mortgage bonds. There would be a little over a million shares of common stock behind the mortgage, of which the old shareholders would hold 86,000, the City Investing Company about 70,000 and the remainder would be distributed between the two, according as the shareholders should have taken up their options. The amount of cash which would be left to carry on was necessarily speculative; but the prospect was undoubtedly of a much smaller margin than had been the company's habit in the past; perhaps it was so small that a majority of the shareholders would have preferred to take ten per cent of their holdings and let the option go. That was, however, not a question for the debenture holders or for the trustee; indeed, it was not even a question for the judge. It was for a majority of the shareholders, and for them alone, to decide whether they preferred to accept the chance of being able to pay the interest on the first mortgage; and if they chose to do so, the judge would not have been justified in interfering in their choice; it was a practical decision within the powers of the majority; Chapter X does not give to the bankruptcy court any larger supervision in such a situation than if the new company had been set up and sent upon its way.

In conclusion, therefore, we can see no reason why the "alteration" should not have been submitted under § 222; and we hold that it was an error to deny the petition. Upon remand the question will be whether the City Investing Company—or for that matter, any other equally responsible underwriter—will within a reasonable time come forward with a reliable and practical offer which will produce enough money to pay off the debenture bonds, principal and interest. If such an offer is forthcoming, it should be treated as a permissible "alteration" or "modification" of the plan under § 222, and the judge should "approve" it,

provided he finds that it satisfies the conditions we have just mentioned. Thereupon he should fix a hearing for its "consideration" under § 222, and "a subsequent time for its acceptance or rejection" under §§ 222 and 223. Since the only persons whose interest can be "adversely affected" by such a change in the plan, are the shareholders, it follows that their votes alone will determine acceptance or rejection. Section 222 speaks in the alternative: creditors "or" shareholders. It is not necessary to say anything of the two ancillary orders; they necessarily fall with the main order.

Orders reversed.

APPENDIX E.

Bankruptcy Act, Section 77 (e).

[U. S. C., 205 (e).]

Court Hearing After Approval by Commission; Acceptance of Plan by Creditors and Stockholders; Confirmation of Plan by Court; Valuation of Property.

(e) Upon the certification of a plan by the Commission to the court, the court shall give due notice to all parties in interest of the time within which such parties may file with the court their objections to such plan, and such parties shall file, within such time as may be fixed in said notice, detailed and specific objections in writing to the plan and their claims for equitable treatment. The judge shall, after notice in such manner as he may determine to the debtor, its trustee or trustees, stockholders, creditors, and the Commission, hear all parties in interest in support of, and in opposition to, such objections to the plan and such claims for equitable treatment. After such hearing, and without any hearing if no objections are filed, the judge shall approve the plan if satisfied that: (1) it complies with the provisions of subsection (b) of this section, is fair and equitable, affords due recognition to the rights of each class of creditors and stockholders, does not discriminate unfairly in favor of any class of creditors or stockholders, and will conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders; (2) the approximate amounts to be paid by the debtor, or by any corporation or corporations acquiring the debtor's assets, for expenses and fees incident to the reorganization, have been fully disclosed so far as they can be ascertained at the date of such hearing, are reasonable, are within such maximum limits as are fixed by the Commission, and are within

such maximum limits to be subject to the approval of the judge; (3) the plan provides for the payment of all costs of administration and all other allowances made or to be made by the judge, except that allowances provided for in subsection (c), paragraph (12) of this section, may be paid in securities provided for in the plan if those entitled thereto will accept such payment, and the judge is hereby given power to approve the same.

If the judge shall not approve the plan, he shall file an opinion, stating his conclusions and the reason therefor, and he shall enter an order in which he may either dismiss the proceedings, or in his discretion and on motion of any party in interest refer the proceedings back to the Commission for further action, in which event he shall transmit to the Commission a copy of any evidence received. If the proceedings are referred back to the Commission, it shall proceed to a reconsideration of the proceedings under the provisions of subsection (d) of this section. If the judge shall approve the plan, he shall file an opinion, stating his conclusions and the reasons therefor, and enter an order to that effect, and shall send a certified copy of such opinion and order to the Commission. The plan shall then be submitted by the Commission to the creditors of each class whose claims have been filed and allowed in accordance with the requirements of subsection (c) of this section, and to the stockholders of each class, and/or to the committees or other representatives thereof, for acceptance or rejection, within such time as the Commission shall specify, together with the report or reports of the Commission thereon or such a summarization thereof as the Commission may approve, and the opinion and order of the judge: Provided, That submission to any class of stockholders shall not be necessary if the Commission shall have found, and the judge shall have affirmed the finding, (a) that at the time of the finding the corporation is insolvent, or that at the time of the finding the

equity of such class of stockholders has no value, or that the plan provides for the payment in cash to such class of stockholders of an amount not less than the value of their equity, if any, or (b) that the interests of such class of stockholders will not be adversely and materially affected by the plan, or (c) that the debtor has pursuant to authorized corporate action accepted the plan and its stockholders are bound by such acceptance: Provided further, That submission to any class of creditors shall not be necessary if the Commission shall have found, and the judge shall have affirmed the finding, that the interests of such class of creditors will not be adversely and materially affected by the plan, or that at the time of the finding the interests of such class of creditors have no value, or that the plan provides for the payment in cash to such class of creditors of an amount not less than the value of their interests. For the purpose of this section the acceptance or rejection by any creditor or stockholder shall be in writing, executed by him or by his duly authorized attorney, committee, or representative. If the United States of America, or any agency thereof, or any corporation (other than the Reconstruction Finance Corporation) the majority of the stock of which is owned by the United States of America, is a creditor or stockholder, the interests or claims thereof shall be deemed to be affected by the plan, and the President of the United States, or any officer or agency he may designate, is hereby authorized to act in respect of the interests or claims of the United States or of such agency or other corporation. The expense of such submission shall be certified by the Commission and shall be borne by the debtor's estate. The Commission shall certify to the judge the results of such submission.

Upon receipt of such certification, the judge shall confirm the plan if satisfied that it has been accepted by or on behalf of creditors of each class to which submission

is required under this subsection holding more than two-thirds in amount of the total of the allowed claims of such class which have been reported in said submission as voting on said plan, and by or on behalf of stockholders of each class to which submission is required under this subsection holding more than two-thirds of the stock of such class which has been reported in said submission as voting on said plan; and that such acceptances have not been made or procured by any means forbidden by law: Provided, That, if the plan has not been so accepted by the creditors and stockholders, the judge may nevertheless confirm the plan if he is satisfied and finds, after hearing, that it makes adequate provision for fair and equitable treatment for the interests or claims of those rejecting it; that such rejection is not reasonably justified in the light of the respective rights and interests of those rejecting it and all the relevant facts; and that the plan conforms to the requirements of clauses (1) to (3), inclusive, of the first paragraph of this subsection (e); Provided further, That if, in any reorganization proceeding under this section, the United States is a creditor on claims for taxes or customs duties (whether or not the United States has any other interest in, or claim against, the debtor, as creditor or stockholder), no plan which does not provide for the payment thereof shall be confirmed by the judge except upon the acceptance, certified to the court, of a lesser amount by the President of the United States or the officer or agency designated by him pursuant to the provisions of the preceding paragraph hereof: Provided further, That if the President of the United States or such officer or agency shall fail to accept or reject such lesser amount for more than ninety days after receipt of written notice so to do from the court, accompanied by a certified copy of the plan, the consent of the United States insofar as its claims for taxes or customs duties are concerned shall be conclusively presumed. If the judge shall confirm the

plan, he shall enter an order and file an opinion with a statement of his conclusions and his reasons therefor. If the judge shall not confirm the plan, he shall file an opinion, with a statement of his conclusions and his reasons therefor, and enter an order in which he shall either dismiss the proceedings, or, in his discretion and on the motion of any party in interest, refer the case back to the Commission for further proceedings, including the consideration of modifications of the plan or the proposal of new plans. In the event of such a reference back to the Commission, the proceedings with respect to any modified or new plan shall be governed by the provisions of this section in like manner as in an original proceeding hereunder.

If it shall be necessary to determine the value of any property for any purpose under this section, the Commission shall determine such value and certify the same to the court in its report on the plan. The value of any property used in railroad operation shall be determined on a basis which will give due consideration to the earning power of the property, past, present, and prospective, and all other relevant facts. In determining such value only such effect shall be given to the present cost of reproduction new and less depreciation and original cost of the property, and the actual investment therein, as may be required under the law of the land, in light of its earning power and all other relevant facts.